

November 16, 2009

Self-Regulatory Organizations; The Options Clearing Corporation; Order Approving Proposed Rule Change to Revise the Minimum Eligibility Criteria for Common Stock Loaned Through Stock Loan Programs and Deposited as Margin Collateral

I. Introduction

On August 28, 2009, The Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission (“Commission”) proposed rule change SR-OCC-2009-15 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”).¹ The proposed rule change was published for comment in the Federal Register on October 6, 2009.² No comment letters were received on the proposal. This order approves the proposal.

II. Description

The proposed rule change revises minimum eligibility criteria applicable to common stock loaned through OCC’s Stock Loan Programs and deposited as margin collateral.

OCC’s clearing services involve common stock³ in several ways. Stocks are: (i) underlying securities for exchange-traded equity option contracts; (ii) constituent securities of stock indexes that underlie stock index options or of indexes on which underlying ETFs are based; (iii) constituent securities of ETFs that although are not underlying securities are based on indexes that underlie index options (“Index Option Related ETFs”); (iv) the subject of stock loan or borrow transactions cleared pursuant to OCC’s Stock Loan Programs; and (v) deposited with

¹ 15 U.S.C. 78s(b)(1).

² Securities Exchange Act Release No. 60743 (September 29, 2009), 74 FR 51348.

³ The term “common stock” or “stock” is broadly used in this rule change to refer to different types of equity securities including ETFs but not preferred stock.

OCC as margin collateral. Rationalizing the interrelationship among the criteria applied to stocks for these various purposes will maximize the potential for offsets and reduce risk in the clearing system.

Under OCC's Stock Loan Programs, only loans of stocks that are either underlying securities for options or futures or ETFs based on a stock index underlying an index option contract are eligible for clearance through OCC (collectively, "Options-Related Stocks"). OCC restricted stock loan activity to limit its risk to loans supporting short sales that might be serving as hedges for options transactions or helping to add liquidity to the options markets. At the time this criterion was implemented in 2002, OCC managed the risk of stock loan transactions for most clearing members on a credit basis—that is OCC did not collect margin on such transactions. As noted above, OCC now requires margin on all stock loan transactions thus reducing the risk associated with this activity. Accordingly, OCC believes that it is no longer necessary or appropriate to limit stock loan transactions to Options-Related Stocks.

In connection with the foregoing change, OCC is supplementing its existing criteria for stock eligible for the Stock Loan Programs by requiring that in order to qualify as an "Eligible Stock" for purposes of the Stock Loan Programs a stock must be a "covered security" as defined in Section 18(b)(1) of the Securities Act of 1933.⁴ By agreement with the options exchanges, OCC already requires that all underlying stocks meet this criterion, and OCC believes that it is an appropriate minimum assurance of quality. In addition, OCC is imposing a \$3 minimum

⁴ "Covered securities" are securities that are authorized for listing on the New York Stock Exchange, the American Stock Exchange (now known as NYSE Amex LLC), the National Market System of the Nasdaq Stock Market (collectively, "Exchanges"), or any other national securities exchange, or tiers thereof, that the Commission determines are substantially similar to the listing standards applicable to securities on the Exchanges. 15 U.S.C. 77r(b)(1).

share price requirement that is applicable only to stocks other than Options-Related Stocks.⁵

OCC, however, retains the ability to waive the \$3 minimum price where specified other factors suggest that the stock is nevertheless suitable for inclusion in the Stock Loan Programs.

Common Stock as Collateral

Under current OCC Rule 604(b)(4), clearing members can deposit common stocks that meet the following criteria: minimum price of \$3 per share and traded on a national securities exchange or traded in the Nasdaq Global Market or the Nasdaq Capital Market. The aggregate value of margin attributed to a single stock cannot exceed 10% of a clearing member's total margin requirement. Stocks are haircut by 30% for margin valuation purposes. Stocks that have been suspended from trading by or are subject to special margin requirements under the rules of a listing market because of volatility, lack of liquidity, or similar characteristics are not eligible for deposit as margin.

Under the approved but not yet implemented Collateral in Margins program, any common stock that meets the above criteria except the minimum price requirement and that is deliverable upon exercise or maturity of a cleared contract (i.e., is an underlying security), as well as index option related ETFs, will be afforded collateral value as determined by STANS. Moreover, the margin concentration requirement will be inapplicable to such deposits. Thus, upon implementation of the Collateral in Margins proposal, the minimum price requirement and margin concentration requirement will be eliminated for common stocks that are underlying securities or index option related ETFs. The minimum price requirement is being eliminated for these securities in order to provide a greater opportunity for members to hedge their equity

⁵ This minimum price requirement corresponds to the minimum price standard contained in the criteria used by the options exchanges for initial selection of underlying securities that are also "covered securities."

options positions with pledges of the underlying securities. This decision also reflects OCC's judgment that the minimum price requirement is less important in the current environment where OCC is able to closely monitor collateral in the form of common stock and to apply the sophisticated risk management technique incorporated in STANS in order to determine the appropriate value to assign to such collateral. The concentration test requirement is being eliminated because STANS contains its own built-in functionality that adequately handles concentrated options and collateral holdings.

In anticipation of the implementation of the Collateral in Margins program, and effective with such implementation, OCC further amends Rule 604(b)(4)(i) as follows:

- (1) replace the requirement of listing on a national securities exchange or specific Nasdaq markets with the requirement that all common stocks deposited as margin must be "covered securities" as described above;
- (2) provide that the \$3 minimum share price requirement will apply to deposits of common stocks that are not Options Related Stocks;
- (3) permit OCC to waive the \$3 minimum share price if it determines that other factors, including trading volume, the number of shareholders, the number of outstanding shares, and current bid/ask spreads warrant such action; and
- (4) delete Interpretation and Policy .13, adopted in SR-OCC-2009-08, which made the 10% concentration test inapplicable to certain ETFs because the 10% test will be eliminated for all stocks (including ETFs) when Collateral in Margins is implemented.

In addition, OCC is amending Rule 1001 to provide that the determination of "average aggregate daily margin requirement" and "daily margin requirement" are performed without reference to any deposits of securities (e.g., common stocks including fund shares) that were valued within

STANS pursuant to Rule 601. This change ensures that contributions to the clearing fund will be determined without taking into account any reduction in margin requirements resulting from valuing deposits of such securities under STANS. Other proposed changes to Rule 1001 are conforming or clarifying in nature.

The changes proposed in this rule filing more closely align both the stock collateral and stock loan eligibility criteria with the criteria for selection of underlying equity securities. While some differences still exist, OCC believes that the discretionary authority provides OCC with sufficient flexibility to treat equity options, stock loan transactions, and stock collateral in a consistent manner when appropriate. For example, the \$3 minimum price requirement is similar or identical to requirements contained in the equity options listing criteria of the options exchanges. In addition, the factors that OCC will consider in determining whether an exception to the \$3 minimum may be granted are consistent with those reflected in such criteria. These factors are widely regarded as among the most relevant in determining whether a stock is liquid.

STANS's functionality permits OCC to propose these changes. STANS considers a security's historical price volatility in generating its simulated market moves resulting in coverage parameters that vary based on the overall risk of a particular underlying security. STANS also identifies and addresses concentrated positions. By incorporating equity options positions, stock loan positions, and upon implementation of the Collateral in Margins changes common stock deposits within a single concentration analysis, OCC can identify where hedged positions exist and can also identify areas of cumulative exposure where additional collateral may be appropriate (e.g., where a clearing member has long options, stock loan positions, and margin deposits all relating to the same security).

OCC will implement the changes to stock loan eligibility criteria immediately. The

changes in eligibility criteria for common stock deposited as margin will be implemented concurrently with implementation of the Collateral in Margins program, which is scheduled for implementation in the fourth quarter 2009.

III. Discussion

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a registered clearing agency. In particular, the Commission believes that by amending its rules to revise minimum eligibility criteria applicable to common stock loaned through OCC's Stock Loan Programs and deposited as margin collateral, the proposal is consistent with the requirements of Section 17A(b)(3)(F),⁶ which requires, among other things, that the rules of a clearing agency are designed to promote the prompt and accurate clearance and settlement of securities transactions.

IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposal is consistent with the requirements of the Act and in particular with the requirements of Section 17A of the Act⁷ and the rules and regulations thereunder.

⁶ 15 U.S.C. 78q-1(b)(3)(F).

⁷ 15 U.S.C. 78q-1.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,⁸ that the proposed rule change (File No. SR-OCC-2009-15) be, and hereby is, approved.⁹

For the Commission by the Division of Trading and Markets, pursuant to delegated authority.¹⁰

Florence E. Harmon
Deputy Secretary

⁸ 15 U.S.C. 78s(b)(2).

⁹ In approving the proposed rule change, the Commission considered the proposal's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹⁰ 17 CFR 200.30-3(a)(12).