

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-59036; File No. SR-OCC-2008-06)

December 1, 2008

Self-Regulatory Organizations; The Options Clearing Corporation; Order Granting Accelerated Approval of a Proposed Rule Change Relating to the Stock Loan/Hedge Program

I. Introduction

On February 25, 2008, The Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission (“Commission”) and on October 7, 2008, amended proposed rule change File No. SR-OCC-2008-06 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”).¹ Notice of the proposal was published in the Federal Register on November 17, 2008.² No comment letters have been received to date. This order approves the proposed rule change on an accelerated basis.

II. Description

OCC has decided to take certain steps to provide for the continued growth and development of its Stock Loan/Hedge Program (“Program”). These include (1) elimination of the ability of clearing members to carry stock loan and borrow positions without depositing risk margin and (2) adjusting the amount of required risk margin where stock loan collateral provided by the borrower to the lender exceeds the value of the borrowed stock.

Background and General Description of the Proposed Rule Change

The Program is provided for in Article XXI of OCC’s By-Laws and Chapter XXII of the Rules. It provides a means for OCC clearing members to submit certain stock loan/borrow transactions (“stock loan transactions”) to OCC for clearance. The stock and the stock loan

¹ 15 U.S.C. 78s(b)(1).

² Securities Exchange Act Release No. 58901 (November 5, 2008), 73 FR 67918.

collateral move through the facilities of The Depository Trust Company from the lending clearing member (“lender”) to the borrowing clearing member (“borrower”), and vice-versa when the stock is returned, in the same way that such transactions are ordinarily effected. Where the stock loan transaction is submitted to OCC for clearance, however, OCC is substituted as the lender to the borrower and the borrower to the lender. Thereafter, OCC guarantees performance of the stock loan transaction with respect to delivery and return of stock and collateral and the making of daily mark-to-market payments between the lender and borrower, which are effected through OCC’s cash settlement system.

One advantage of submitting stock loan transactions to OCC is that the stock loan and borrow positions then reside in the clearing member’s options accounts at OCC and to the extent that they offset the risk of options positions carried in the same account, may reduce the clearing member’s margin requirement in the account. OCC’s risk is, in turn, reduced by having the benefit of the hedge. Nevertheless, OCC currently permits qualified clearing members to elect to submit stock loan and borrow transactions to OCC on a “margin ineligible basis,” meaning that the positions are excluded from OCC’s margin calculations for the account containing those positions. Margin-ineligible stock loan and borrow positions do not reduce the margin requirement for the account to reflect any offsetting value they might have, and OCC does not collect additional margin to reflect the risk of those positions. The election is made by each clearing member on an account-by-account basis so that all stock loan and borrow positions in a particular account are carried on a margin ineligible basis or none are. In order to carry stock loan and borrow positions on a margin ineligible basis, a clearing member must meet heightened

standards of creditworthiness as set forth in Interpretation and Policy .06 under Section 1 of Article V of OCC's By-Laws.

While OCC believes that the current credit-based risk management approach has been adequate to date given historical Program activity levels, OCC also believes that a more conservative approach is warranted to provide for further growth of the Program and greater market volatility. OCC therefore seeks to better manage the market risk resulting from open stock loan and borrow positions by applying its standard margining approach to all such positions.

Another potential exposure that OCC seeks to address arises from the stock loan market practice of requiring the borrower to overcollateralize a position by giving the lender cash collateral equal to 102% of the position's current market value. OCC's rules provide that OCC's guarantee of Program transactions extends to the full value of the collateral exchanged as part of a stock loan transaction. Therefore, if a lender were to fail, even if the stock could be sold out at 100% of the marking price, the borrower would be left with a 2% deficiency for which OCC would be liable. Managing this potential exposure will be accomplished by (a) an additional margin charge to lenders executing stock loans at 102% in an amount equal to the 2% excess collateral and (b) borrowers receiving a margin credit in an equal amount. These new margin charges/credits are independent of and in addition to the risk margin determined by the "STANS" margining system that will be collected and maintained from both lenders and borrowers.

In connection with the submission of this filing, OCC has confirmed with the Commission staff that the proposed rule change would not have adverse consequences to

clearing members under Rule 15c3-1, the Commission's net capital rule.³ Specifically, where stock loan/borrow transactions are submitted to OCC for clearance through the Program, any additional amount of margin required to be deposited with OCC as a result of such transactions shall be treated the same as any other portion of the OCC margin deposit and therefore shall not constitute an unsecured receivable and shall not be required to be deducted from net capital.

In order to minimize any potential disruptive impact associated with these changes in the margin treatment of stock loan and borrow positions, OCC will utilize a two-step implementation plan. There will be a one-month grace period (beginning from the date of Commission approval of this rule filing) before the changes are applied to any positions. For the next two months, all new positions must be submitted on a margin-eligible basis and will be subject to the overcollateralization provisions, but positions that were carried on a margin-ineligible basis as of the date of the approval order will not be required to be margined or subject to the overcollateralization provisions. After the end of that initial three-month period, all stock loan and borrow positions in all accounts will be carried on a margin-eligible basis and will be subject to the overcollateralization provisions regardless of when the positions were established.

Rule Amendments Applicable to Changes in the Program

OCC proposes the following amendments to its Rules to achieve the above-referenced initiative and accommodate and facilitate the continued growth and development of the Program.

³ 17 CFR 240.15c-3-1.

1. Margin Requirements—Rule 601

OCC will amend Rule 601(e) to eliminate its current category of “margin-ineligible” accounts and instead will apply its standard margining approach to all Program positions using its “STANS” system. This change will become effective three months following the date of the Commission’s order approving this rule filing. In addition, a new interpretation .06 will be added to Rule 601 setting forth the additional margin charges and credits and the implementation schedule applicable to stock loan and borrow positions that have collateral set at 102%.

2. Instructions to the Corporation—Rule 2201

Rule 2201(a) will be amended to provide that with respect to standing instructions that clearing members provide to OCC, the requirement to notify OCC of the fact that the clearing member is approved to maintain stock loan positions and stock borrow positions in its accounts on a non-margined basis and the account or accounts that are to be margin-ineligible shall become inapplicable three months from the date of this order. After that time, OCC will have eliminated the ability to carry any stock loan or borrow positions on a “margin-ineligible” basis.

3. Initiation of Stock Loans—Rule 2202

Rule 2202(f) is being amended to specify that one month after the date of this order a member shall not be able to submit new stock loan transactions to OCC for clearance in a margin-ineligible account.

III. Discussion

Section 19(b)(2)(B) of the Act directs the Commission to approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to such organization.

Section 17A(b)(3)(F) of the Act requires, among other things, that the rules of a clearing agency be designed to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible.⁴ The proposed rule change eliminates the ability of members to carry stock loan/borrow positions on a “margin ineligible” basis which should enhance OCC’s ability to assure that it has collected sufficient margin from its members in relation to such members’ Program activity. This approach enhances OCC’s ability to manage the risk of a clearing member’s Program activity in relation to its general clearance and settlement activities and should better enable OCC to protect itself and its members from potential losses associated with the Program. The addition of implementation period should alleviate any potential disruptive effects for members in connection with the proposal. Accordingly, the Commission finds that the proposed rule change is designed to assure the safeguarding of securities and funds which are in OCC’s custody or control or for which OCC is responsible.

OCC has requested that the Commission approve the proposed rule change prior to the thirtieth day after publication of the notice of filing. The Commission finds good cause for approving the proposed rule changes prior to the thirtieth day after publication of notice and prior to the expiration of the comment period because such approval will permit OCC to implement a risk-reduction proposal without unnecessary delay.

⁴ 15 U.S.C. 78q-1(b)(3)(F).

IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule changes are consistent with the requirements of the Act and in particular Section 17A of the Act and the rules and regulations thereunder.⁵

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR-OCC-2008-06) be and hereby is approved on an accelerated basis.

For the Commission by the Division of Trading and Markets, pursuant to delegated authority.⁶

Florence E. Harmon
Acting Secretary

⁵ In approving the proposed rule changes, the Commission considered the proposals' impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

⁶ 17 CFR 200.30-3(a)(12).