

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-65927; File No. SR-OCC-2011-15)

December 9, 2011

Self-Regulatory Organizations; Options Clearing Corporation; Order Approving Proposed Rule Change Relating to Management of Liquidity Risk

I. Introduction

On October 12, 2011, the Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change SR-OCC-2011-15 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder.² The proposed rule change was published for comment in the Federal Register on November 1, 2011.³ The Commission received no comment letters on the proposed rule change. This order approves the proposed rule change.

II. Description

The purpose of the proposed rule change is to amend OCC’s by-laws and rules to clarify OCC’s authority to use, and the manner in which OCC may use, a defaulting clearing member’s margin deposits and contributions to the clearing fund and all other clearing members’ clearing fund contributions⁴ to obtain temporary liquidity for purposes of meeting liquidity needs arising

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Securities Exchange Act Release No. 65622 (October 28, 2011), 76 FR 67523.

⁴ Margin deposits secure only the depositing clearing member’s own obligations to OCC whereas clearing fund deposits of all clearing members may be applied by OCC not only to losses arising from the depositing clearing member’s default, but also to losses resulting from defaults by other clearing members and specified other third parties such as settlement banks and other clearing organizations. See generally Article VIII, Sections 1 and 5 of OCC’s by-laws and Rule 604 of OCC’s rules.

from Default Obligations.⁵

An essential element of OCC's risk management regime is sound management of liquidity risk. OCC regularly examines its liquidity risk exposure to determine the optimal amount and form of available liquidity. OCC's largest potential liquidity needs are projected to occur in the case of a clearing member's default where OCC would be obligated to settle the defaulting clearing member's payment obligations with respect to option premiums, settlement of cash-settled option exercises, and mark-to-market payments. These are obligations that OCC must fund on time and potentially with only a few hours of advance notice – from notice of default until the payments are due.

One of the resources that OCC may use to meet its liquidity needs is its existing committed credit facility. The amount of funds available to OCC under the committed credit facility is limited not only by the overall size of the facility, but also by the amount of assets that OCC can pledge as collateral to lenders supporting the facility. OCC believes that, in addition to the authority it already has to pledge clearing fund assets to secure a loan to cover Default Obligations, it should also have the express power to pledge a suspended clearing member's margin deposits to secure loans for the purpose of meeting obligations arising out of the default and suspension of that clearing member or any action taken by OCC in connection therewith. OCC clearly has authority to pledge a suspended clearing member's clearing fund deposits for that purpose under Article VIII, Section 5(e) of the by-laws. OCC believes that it is not as clear that it has authority to pledge a suspended clearing member's margin deposits. Rule 1104(a) provides, among other things, that upon the suspension of a clearing member, OCC shall

⁵ The specific language of the proposed changes can be found at http://www.optionsclearing.com/components/docs/legal/rules_and_bylaws/sr_occ_11_15.pdf.

promptly “convert to cash,” in the most orderly manner practicable, all of the clearing member’s margin deposits. Although this mandate might be construed to include the authority to pledge margin assets as collateral for borrowings under the committed credit facility, the phrase “convert to cash” has generally been used in the by-laws as synonymous with “liquidate” to refer to a final disposition of an asset. And even if OCC does have implied authority to pledge margin assets, that may not be transparent to all clearing members because it is not expressly stated in the rule. In order to eliminate any ambiguity, OCC proposed to (i) amend Rule 1104 and Rule 1106 to replace the phrases “convert to cash,” “conversion to cash” and “converted to cash” with the words “liquidate,” “liquidation” and “liquidated,” respectively; and (ii) amend Rule 1104(b) to expressly give OCC the power to pledge a suspended clearing member’s margin deposits as security for loans if designated executive officers of OCC determine that immediate liquidation of such assets for cash under then-existing circumstances would not be in the best interests of OCC, other clearing members, or the general public.

While OCC’s \$2 billion committed credit facility should normally be more than sufficient to meet OCC’s liquidity needs, it is nevertheless possible that OCC could encounter a liquidity demand that exceeds the size of that facility. Moreover, it could be difficult to maintain the size of the facility under unfavorable market conditions (*i.e.*, if the credit markets tighten significantly). In addition, future regulatory requirements for clearinghouses could impose liquidity requirements that would be difficult to meet with a committed credit facility alone. In order to be better prepared to deal with such situations, OCC believes that it is necessary to actively explore a variety of means for raising and maintaining liquidity resources, including participation in securities lending or tri-party repo markets. Therefore, OCC proposed to amend both Article VIII, Section 5(e) of the by-laws and Rule 1104(b) to clarify that OCC’s authority to

use a suspended clearing member's margin and clearing fund deposits and other clearing members' clearing fund deposits to obtain temporary liquidity for purposes of meeting Default Obligations is not limited to pledging such assets under the committed credit facility. Rather, OCC would have express authority to use such assets to obtain liquidity through any reasonable means as determined by designated executive officers of OCC in their discretion. The addition of the language "or otherwise obtain" in Article VIII, Section 5(e) of the by-laws reflects that certain transactions by which OCC may obtain liquidity could be characterized as something other than a transaction in which funds are "borrowed." For example, in a Master Repurchase Agreement, the Agreement states that the parties' intent is for the transactions to be "sales" and "purchases," but also contains provisions if such transactions are deemed to be loans. Accordingly, the use of "or otherwise obtain" in the phrase "borrow or otherwise obtain" addresses the possibility that the transaction by which OCC obtains funds may not be deemed to be a "borrowing" and forestalls technical arguments that it would be necessary for the transaction to be a "loan" in order for OCC to borrow funds.

III. Discussion

Section 17A(b)(3)(F) of the Act requires that the rules of a registered clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions and 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.⁶ The proposed rule change is designed to clarify OCC's authority to take action following a clearing member default in order to facilitate the settlement of the defaulting clearing member's payment obligations with respect to option premiums, settlement of cash-settled option exercises, and mark-to-market payments. The

⁶ 15 U.S.C. 78a-1(b)(3)(F).

Commission believes that the express authority to obtain funds based on a suspended member's clearing fund deposits and margin deposits may facilitate OCC's ability to obtain the liquidity it needs to promote the prompt and accurate clearance and settlement of securities transactions and to assure the safeguarding of securities and funds which are in the custody or control or for which OCC is responsible.

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.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,⁸ that the proposed rule change (File No. SR-OCC-2011-15) be, and hereby is, approved.⁹

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

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Deputy Secretary

⁷ 15 U.S.C. 78q-1.

⁸ 15 U.S.C. 78s(b)(2).

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

¹⁰ 17 CFR 200.30-3(a)(12).