

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-64181; File No. SR-OCC-2010-19)

April 5, 2011

Self-Regulatory Organizations; The Options Clearing Corporation; Order Approving a Proposed Rule Change Relating to Stock Loan Programs

I. Introduction

On December 16, 2010, The Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission a proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”).¹ The proposed rule change clarifies the regulatory treatment under Rule 15c3-1² of collateral and margin posted by clearing members participating in stock loan transactions through OCC’s Stock Loan/Hedge Program or Market Loan Program. The proposed rule change was published for comment in the Federal Register on January 5, 2011.³ No comment letters were received. This order approves the proposed rule change.

II. Description of the Proposal

A. Background

OCC’s Stock Loan/Hedge Program, provided for in Article XXI of OCC’s By-Laws and Chapter XXII of OCC’s Rules, provides a means for OCC clearing members to submit broker-to-broker stock loan transactions to OCC for clearance. Broker-to-broker transactions are independently-executed stock loan transactions that are negotiated directly between two OCC clearing members. OCC’s Market Loan Program, provided for in Article XXIA of OCC’s By-Laws and Chapter XXIIA of OCC’s Rules, accommodates securities loan transactions executed

¹ 15 U.S.C. 78s(b)(1).

² 17 C.F.R. 240.15c3-1.

³ Securities Exchange Act Release No. 63623 (Dec. 30, 2010), 76 FR 0602.

through electronic trading platforms that match lenders and borrowers on an anonymous basis. Anonymous stock loan transactions are initiated when a lender or borrower, which is either an OCC clearing member participating in the Market Loan Program or a non-clearing member that has a clearing relationship with an OCC clearing member participating in the Market Loan Program, accepts a bid/offer displayed on a trading platform.⁴

When a stock loan transaction is submitted to and accepted by OCC for clearance, OCC substitutes itself as the lender to the borrower and as the borrower to the lender thus serving a function for the stock loan market similar to the one it serves for the listed options market. OCC guarantees the future daily mark-to-market payments, which are effected through OCC's cash settlement system, between the lending clearing member and borrowing clearing member and guarantees the return of the loaned stock to the lending clearing member and the return of the collateral to the borrowing clearing member upon close-out of the stock loan transaction.⁵ One advantage of submitting stock loan transactions to OCC is that the stock loan and stock borrow positions then reside in the clearing member's options account 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.

One of the tools that OCC uses to manage its exposure to stock loan transactions is the

⁴ A clearing member participating in the Market Loan Program is obligated to OCC as principal with respect to transactions effected by its customers that are non-clearing members of a trading platform.

⁵ With respect to both the Stock Loan/Hedge Program and the Market Loan Program, the loaned securities are moved to the account of the borrower against cash collateral (normally 102%) through the facilities of The Depository Trust Company ("DTC"). DTC notifies OCC that the movement has occurred at the time the transaction is submitted for clearance. The securities are returned to the lender against return of the cash collateral through the same mechanism.

margin that OCC calculates and collects with respect to each account of a clearing member.⁶ Such margin consists of a mark-to-market component that is based on the net asset value of the account (i.e., the cost to liquidate the account at current prices). A second component of such margin is the risk component (“Risk Margin”) determined by OCC’s proprietary margin system based on the net risk of all open positions carried in the account, including stock loan positions as well as options positions.⁷ An additional margin requirement (“Additional Margin”), which is solely applicable to stock loan transactions, arises where the collateral provided by the borrowing clearing member is greater than the current market value of the loaned stock. For example, in a stock loan transaction where the borrowing clearing member is required to provide collateral equal to 102% of the current market value of the loaned stock, OCC will charge the corresponding lending clearing member an Additional Margin amount equal to the 2% excess collateral and will credit the borrowing clearing member an equal amount. The Additional Margin charge/credit is designed to provide OCC with resources so it can fully compensate a party to a stock loan transaction in the event of a counterparty default where the loaned stock or collateral held by the non-defaulting party is worth less than the value of the collateral or loaned stock exchanged.

B. Description of Rule Change

In December 2008, the Commission approved an OCC proposed rule change that memorialized OCC’s understanding that where stock loan transactions are submitted to OCC for clearance through the Stock Loan/Hedge Program, any Additional Margin that a clearing

⁶ This OCC margin requirement is in addition to the cash collateral that is transferred to the stock lender and may be deposited in any form constituting acceptable margin collateral under OCC Rule 604.

⁷ OCC does not calculate risk margin on stock loan positions and stock borrow positions separately from risk margin on options positions carried in the same account.

member is required to deposit with OCC will be treated the same as any other portion of the OCC margin deposit requirement and therefore will not constitute an unsecured receivable that would otherwise be required to be deducted from such clearing member's net capital for purposes of Rule 15c3-1.⁸

Pursuant to this rule change, OCC is expanding the prior interpretive relief to make clear that: (i) clearing members are not be required to take a net capital deduction with respect to any excess of the collateral over the market value of the loaned stock and (ii) the interpretive relief also applies to stock loan transactions submitted to OCC for clearance through the Market Loan Program. As explained above, any over-collateralization of the loaned stock will be secured and offset by Additional Margin charges/credits applied by OCC. Therefore, any such excess collateral on loaned stock also would not be deemed to constitute an unsecured receivable for purposes of Rule 15c3-1.

In connection with the above-referenced initiatives, OCC will amend Interpretation .05 to OCC Rule 601 to reflect the regulatory treatment under Rule 15c3-1 of collateral and margin posted by clearing members participating in stock loan transactions through the Stock Loan/Hedge Program and/or Market Loan Program.⁹

III. Discussion

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

⁸ Securities Exchange Act Release No. 59036 (Dec. 1, 2008), 73 FR 74554 (Dec. 8, 2008).

⁹ The text of the proposed amendment to Interpretation .05 can be found at http://www.optionsclearing.com/components/docs/legal/rules_and_bylaws/sr_occ_10_19.pdf.

control of the clearing agency or for which it is responsible.¹⁰ OCC's rule change to provide additional interpretive relief with respect to the net capital treatment of stock loan transactions extends OCC's previous changes to its Stock Loan/Hedge Program¹¹ and is similarly designed to enhance OCC's ability to assure that it has collected sufficient margin from its members in relation to such members' activity. The new interpretive relief should continue to provide OCC with the ability to manage the risk of a clearing member's stock loan activity and should continue to enable OCC to protect itself and its members from potential losses associated with the stock loan program. 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.

IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule change is consistent with the requirements of the Act and in particular Section 17A of the Act¹² and the rules and regulations thereunder.

¹⁰ 15 U.S.C. 78q-1(b)(3)(F).

¹¹ Supra note 8.

¹² 15 U.S.C. 78q-1.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹³ that the proposed rule change (File No. SR-OCC-2010-19) be and hereby is approved.¹⁴

For the Commission by the Division of Trading and Markets, pursuant to delegated authority.¹⁵

Cathy H. Ahn
Deputy Secretary

¹³ 15 U.S.C. 78s(b)(2).

¹⁴ 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).

¹⁵ 17 CFR 200.30-3(a)(12).