

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-77415; File No. SR-OCC-2016-006)

March 22, 2016

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Related to the Voluntary Termination by Offset and Re-matching of Matched-Book Positions in the Stock Loan/Hedge Program

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on March 15, 2016, The Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared primarily by OCC. OCC filed the proposed rule change pursuant to Section 19(b)(3)(A)(iii)³ of the Act and Rule 19b-4(f)(4)(i)⁴ thereunder so that the proposal was effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the rule change from interested persons.

I. Clearing Agency’s Statement of the Terms of Substance of the Proposed Rule Change

The purpose of this proposed rule change is to enhance the overall resilience of OCC’s Stock Loan/Hedge Program⁵ by allowing OCC to close out the Matched-Book Positions (as defined herein) of Hedge Clearing Members requesting an orderly wind

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A)(iii).

⁴ 17 CFR 240.19b-4(f)(4)(i).

⁵ See Article XXI of OCC’s By-Laws and Chapter XXII of OCC’s Rules. It is also noted that no changes are being proposed to Article XXIA of OCC’s By-Laws or Chapter XXIIA of OCC’s Rules, which address OCC’s Market Loan Program.

down of Matched-Book Positions through the termination by offset and “re-matching” of such positions without requiring the transfer of securities against the payment of settlement prices as currently required under OCC’s rules. All capitalized terms not defined herein have the same meaning as in OCC’s By-Laws and Rules.⁶

II. Clearing Agency’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, OCC included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. OCC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of these statements.

(A) Clearing Agency’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

OCC proposes amendments to its By-Laws and Rules designed to enhance the overall resilience of OCC’s Stock Loan/Hedge Program by allowing OCC to close out the Matched-Book Positions of a Hedge Clearing Member requesting an orderly wind down of Matched-Book Positions through the termination by offset and re-matching of such positions without requiring the transfer of securities against the payment of settlement prices as currently required under OCC’s rules. The proposed termination by offset and re-matching of stock loan and borrow positions is designed to leave the affected Clearing Members with the same net position in such stock loan and borrow positions as prior to the adjustment.

⁶ Staff has inserted this sentence based on OCC’s request to clarify the use of capitalized terms by OCC in these statements prepared by OCC.

Background

In the Stock Loan/Hedge Program, OCC acts as a central counterparty (“CCP”) for Hedge Loans that are directly negotiated by Hedge Clearing Members and sent to OCC for clearance and settlement. A prospective Lending Clearing Member and a prospective Borrowing Clearing Member identify each other (independent of OCC) and agree on the terms of the stock loan. The Hedge Clearing Members then send the details of the stock loan to The Depository Trust Company (“Depository”) with a certain “reason code,”⁷ which designates the stock loan as a Hedge Loan for guaranty and clearance at OCC. The Lending Clearing Member instructs the Depository to transfer a specified number of shares of Eligible Stock to the account of the Borrowing Clearing Member, and the Borrowing Clearing Member instructs the Depository to transfer the appropriate amount of cash collateral to the account of the Lending Clearing Member.⁸ The Depository then sends the Hedge Loan information to OCC via an end-of-day report.⁹ After OCC receives the report from the Depository, OCC validates and novates the stock loan transaction and becomes the lender to the Borrowing Clearing Member and the borrower to the Lending Clearing Member.¹⁰

⁷ Unique reason codes were created by the Depository for Clearing Members to designate stock loan transactions intended to be sent to OCC for novation and guarantee.

⁸ See OCC Rule 2202(a).

⁹ See OCC Rule 2202(b).

¹⁰ *Id.*

After novation, as part of the guaranty, OCC makes Mark-to-Market Payments for all Hedge Loans on a daily basis to collateralize all loans to the negotiated levels.¹¹ As the CCP, OCC guarantees the return of the full value of cash collateral to a Borrowing Clearing Member and the Loaned Stock, or value of that Loaned Stock, to the Lending Clearing Member. Settlements generally are combined and netted against other OCC settlement obligations in a Hedge Clearing Member's account, including trade premiums and margin deficits. A Hedge Clearing Member's open positions in the Stock Loan/Hedge Program are factored into the Hedge Clearing Member's overall Margin¹² and Clearing Fund contribution requirements.¹³

A significant portion of the activity in OCC's stock lending programs relates to what is often referred to as matched-book activity where a Hedge Clearing Member maintains in an account a stock loan position for a specified number of shares of an Eligible Stock reflecting a stock lending transaction with one Hedge Clearing Member (the Borrowing Clearing Member) and also maintains in that same account a stock borrow position for the same number, or lesser number, of shares of the same Eligible Stock with another Hedge Clearing Member (the Lending Clearing Member) (such positions being "Matched-Book Positions"). From a daily mark-to-market settlement perspective, there are typically no obligations related to Matched-Book Positions because

¹¹ Mark-to-Market Payments are based on the value of the loaned securities and made between Clearing Members using OCC's cash settlement system. The percentage of the value of the loaned securities, either 100% or 102%, is dependent upon the agreement between the two Hedge Clearing Members party to the transaction.

¹² See OCC Rules 601 and 2203.

¹³ See OCC Rule 1001.

the member is simultaneously borrowing and lending the same securities (and quantity), which are marked to the same price. OCC's margin process recognizes this and currently nets loans and borrows in the same security prior to calculating exposure, resulting in no margin on a perfectly matched position.

Currently, in order for a Hedge Clearing Member to close out its stock loan positions, including Matched-Book Positions, the Hedge Clearing Member is required to terminate its loans through instructions issued to the Depository to transfer a specified quantity of the loaned stock against payment of the settlement price in accordance with the process prescribed in Rule 2208. Borrowing and Lending Clearing Member counterparties to the Matched-Book Positions that wish to maintain equivalent stock loan positions at OCC would then be required to initiate new stock loans, through the process described above, in accordance with Rule 2202. Throughout this process of terminating and reestablishing stock loan positions, a number of operational steps are required to effectuate and settle those transactions, which introduce the potential for market disruption. For example, because OCC maintains stock loan inventory on a bilateral basis (i.e., maintains the borrower and lender to a transaction) and guarantees the return of cash collateral and the Loaned Stock, or price of the Loaned Stock, if a Hedge Clearing Member with Matched-Book Positions fails to fulfill its obligations for the recall of loans and return of borrowed shares, there would be a temporary imbalance of the previously "matched-book" position. In addition, the successful initiation of new replacement stock loans for the Borrowing or Lending Clearing Members could be subject to disruption by operational or execution risks, with the result that one "leg" of the initiating transaction would fail. Moreover, the Borrowing and Lending Clearing

Members lose the protections afforded by OCC's guaranty of their stock loan positions until the newly initiated stock loan positions have been accepted, novated, and guaranteed by OCC.

The proposed rule change would permit a Hedge Clearing Member to request the orderly wind down of Matched-Book Positions, subject to the agreement of all affected Borrowing and Lending Clearing Members, without requiring the transfer of securities against the payment of settlement prices as currently required under OCC Rules 2202, 2208 and 2209. OCC believes the proposed rule change would eliminate the potential risks described above associated with the transfer of securities and funds and provide the overall marketplace with more stability with respect to the process of voluntarily closing out Matched-Book Positions in the Stock Loan/Hedge Program.

Voluntary Termination by Offset and Re-Matching

OCC proposes to amend its By-Laws and Rules to permit a Hedge Clearing Member to request an orderly wind down of its Matched-Book Positions, contingent upon the explicit agreement of the requesting Hedge Clearing Member, its counterparty Borrowing Clearing Member, and counterparty Lending Clearing Member, and at the sole discretion of OCC, without requiring the transfer of securities against the payment of settlement prices as currently required under OCC's rules. First, OCC proposes to amend Article I of its By-Laws to add new defined terms "Matched-Book Borrowing Clearing Member," which would mean, with respect to any Matched-Book Positions, the Hedge Clearing Member that borrows Eligible Stock from a Hedge Clearing Member maintaining Matched-Book Positions in that Eligible Stock and "Matched-Book Lending Clearing Member," which would mean, with respect to any Matched-Book Positions, the

Hedge Clearing Member that lends Eligible Stock to a Hedge Clearing Member maintaining Matched-Book Positions in that Eligible Stock. OCC also proposes to add a new definition for “Matched-Book Positions,” which would be defined as Hedge Loan positions in which a single Hedge Clearing Member borrows Eligible Stock from its Matched-Book Lending Clearing Member and lends an equal or lesser amount of the same Eligible Stock to its Matched-Book Borrowing Clearing Member.

In addition, OCC proposes to amend Rule 2208 to adopt new rules for the voluntary termination by offset and re-matching of Matched-Book Positions. Specifically, OCC proposes to adopt new Rule 2208(e)(1), which would provide that a Hedge Clearing Member may submit a written request to OCC to effect one or more position adjustments to terminate by offset all or some of its Matched-Book Positions if the following conditions are met. First, the requesting Hedge Clearing Member, its Matched-Book Lending Clearing Member, and its Matched-Book Borrowing Clearing Member have furnished to the Corporation their written agreement to (i) the termination by offset of such Matched-Book Positions maintained in the requesting Hedge Clearing Member’s account and (ii) the Corporation’s re-matching the stock borrow position for the same number of shares in the same Eligible Stock maintained in a designated account of the Matched-Book Borrowing Clearing Member against the stock loan position for the same number of shares in the same Eligible Stock maintained in a designated account of the Matched-Book Lending Clearing Member. Second, the written agreement furnished by the requesting Hedge Clearing Member, the Matched-Book Borrowing Clearing Member, and the Matched-Book Lending Clearing Member must be in the form specified by OCC. Third, the written request to terminate by offset and to re-match stock loan and

borrow positions may be for less than the total number of shares of the Eligible Stock that is the subject of the stock loan and borrow positions maintained, as applicable, by the requesting Hedge Clearing Member, the Matched-Book Borrowing Clearing Member, and Matched-Book Lending Clearing Member, but must be for an equal number of shares.

Additionally, proposed Rule 2208(e)(2) would provide that, if OCC in its sole discretion approves the requested termination by offset and re-matching of positions, the requesting Hedge Clearing Member, the Matched-Book Borrowing Clearing Member, and Matched-Book Lending Clearing Member would not be required to issue instructions to the Depository to terminate such stock loans and stock borrow positions maintained in the Stock Loan/Hedge Program or to initiate new stock lending transactions for inclusion in the Stock Loan/Hedge Program as currently required under Rules 2202(a) and 2208(a).

Proposed Rules 2208(e)(3) and (4) would provide that, from and after the time OCC has completed the requested position adjustments to terminate by offset and re-match the specified stock loan and borrow positions, the requesting Hedge Clearing Member would have no further obligation under the By-Laws and Rules with respect to such positions; however, the Borrowing Clearing Member with re-matched stock borrow positions remains obligated as a Borrowing Clearing Member and the Lending Clearing Member with re-matched stock loan positions remains obligated as a Lending Clearing Member with respect to the re-matched positions as specified in the By-Laws and Rules applicable to the Stock Loan/Hedge Program.

Proposed Rule 2208(e)(5) would require the requesting Hedge Clearing Member and re-matched Borrowing Clearing Member and Lending Clearing Member to make any

necessary bookkeeping entries at the Depository necessitated by the termination by offset and re-matching upon notification that the termination by offset and re-matching has been completed as set forth in proposed Rule 2209(h).

In addition, OCC proposes to adopt new Rule 2209(h) to specify that, in the event of a termination by offset and re-matching of a stock loan under proposed Rule 2208(e), such termination by offset and re-match shall be complete upon OCC completing all position adjustments in the accounts of the requesting Hedge Clearing Member, the Matched-Book Borrowing Clearing Member, and the Matched-Book Lending Clearing Member in accordance with Rule 2208(e) and the earlier of (i) communicating confirmation of the transaction in the form of direct written communications with the requesting Hedge Clearing Member, the Matched-Book Borrowing Clearing Member, and the Matched-Book Lending Clearing Member or (ii) when systems reports are produced and provided to the Clearing Members reflecting the transaction.

OCC also proposes conforming and clean-up changes to Article XXI, Sections 2, 3 and 4 of its By-Laws. Article XXI, Section 2 would be revised to (i) account for the netting of stock loan and stock borrow positions during the voluntary termination by offset and re-matching of Matched-Book Positions in accordance with proposed Rule 2208(e) and (ii) make clean-up changes to ensure the consistent use of the defined term “Eligible Stock.” Additionally, Article XXI, Sections 3 and 4 would be revised to state that the voluntary termination by offset of Matched-Book Positions in accordance with proposed Rule 2208(e) would be excluded from the requirement to pay the settlement price against delivery of the Loaned Stock as currently required for all terminations under OCC’s existing rules.

2. Statutory Basis

OCC believes the proposed rule change is consistent with Section 17A(b)(3)(F) of the Securities Exchange Act of 1934, as amended (the “Act”),¹⁴ and the rules thereunder applicable to OCC. The proposed rule change would allow OCC to close out the Matched-Book Positions of Hedge Clearing Members, which could include distressed Hedge Clearing Members or Hedge Clearing Members otherwise wishing to wind down their Matched-Book Positions in an orderly manner, through the termination by offset and re-matching of such positions. As described above, under OCC’s existing rules, the close out of Matched-Book Positions requires the transfer of securities against the payment of settlement prices. Moreover, to the extent Borrowing and Lending Clearing Member counterparties to the Matched-Book Positions wish to continue to maintain equivalent stock loan positions at OCC, those members would be required to initiate new stock loans to replace the closed out positions. Throughout this process of terminating and reestablishing stock loan positions, a number of operational steps are required to effectuate and settle those transactions, which introduce the potential for execution and operational risks and thereby pose risks to the prompt and accurate clearance and settlement of securities transactions and the safeguarding of securities and funds associated therewith.

The proposed rule change would eliminate these risks by allowing OCC and its Hedge Clearing Members to close out Matched-Book Positions through a process of termination by offset and re-matching without requiring the transfer of securities and funds. Moreover, due to the nature of Matched-Book Positions, the proposed position

¹⁴ 15 U.S.C. 78q-1(b)(3)(F).

adjustments would enable the requesting Hedge Clearing Member to orderly wind down its Matched-Book Positions while ensuring the Matched-Book Borrowing and Matched-Book Lending Clearing Members' positions are continuously protected by OCC's guaranty. OCC therefore believes the proposed rule change is designed to promote the prompt and accurate clearance of settlement of securities transactions, the safeguarding of securities and funds in the custody or control of OCC or for which it is responsible and, in general, to protect investors and the public interest in accordance with Section 17A(b)(3)(F) of the Act.¹⁵

(B) Clearing Agency's Statement on Burden on Competition

OCC does not believe that the proposed rule change would have any impact or impose any burden on competition.¹⁶ The proposed rules would be equally applicable to all Hedge Clearing Members at OCC. The proposed rule change is designed to allow for the termination by offset and re-matching of Matched-Book Positions without requiring the transfer of securities and funds between Hedge Clearing Members and exposing OCC's members to the risks attendant to such transfers (as described in detail above). Accordingly, OCC does not believe that the proposed rule change would have any impact or impose any burden on competition.

(C) Clearing Agency's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

Written comments on the proposed rule change were not and are not intended to be solicited with respect to the proposed rule change and none have been received.

¹⁵ *Id.*

¹⁶ 15 U.S.C. 78q-1(b)(3)(I).

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

The foregoing rule change has become effective upon filing¹⁷ pursuant to Section 19(b)(3)(A)(iii) of the Act¹⁸ and Rule 19b-4(f)(4)(i) thereunder¹⁹ as it effects a change in an existing service of a registered clearing agency that (1) does not adversely affect the safeguarding of securities or funds in the custody or control of the clearing agency or for which it is responsible and (2) does not significantly affect the respective rights or obligations of the clearing agency or persons using the service. At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

¹⁷ Notwithstanding its immediate effectiveness, implementation of this rule change will be delayed until this change is deemed certified under CFTC Regulation §40.6.

¹⁸ 15 U.S.C. 78s(b)(3)(A)(iii).

¹⁹ 17 CFR 240.19b-4(f)(4)(i).

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-OCC-2016-006 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-OCC-2016-006. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of OCC and on OCC's website at http://www.theocc.com/components/docs/legal/rules_and_bylaws/sr_occ_16_006.pdf.

All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-OCC-2016-006 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²⁰

Brent J. Fields
Secretary

²⁰ 17 CFR 200.30-3(a)(12).