

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-89792; File No. SR-OCC-2020-805)

September 9, 2020

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of No Objection to Advance Notice Concerning Proposed Changes to Enhance OCC's Stock Loan Close-Out Process

**I. INTRODUCTION**

On July 14, 2020, The Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission (“Commission”) advance notice SR-OCC-2020-805 (“Advance Notice”) pursuant to Section 806(e)(1) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, entitled Payment, Clearing and Settlement Supervision Act of 2010 (“Clearing Supervision Act”)<sup>1</sup> and Rule 19b-4(n)(1)(i)<sup>2</sup> under the Securities Exchange Act of 1934 (“Exchange Act”)<sup>3</sup> to require Clearing Members that OCC instructs to buy-in or sell-out securities to execute such transactions and provide OCC notice of such action by the settlement time on the business day after OCC gives the instruction.<sup>4</sup> The Advance Notice was published for public comment in the Federal Register on August 14, 2020,<sup>5</sup> and the Commission has

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<sup>1</sup> 12 U.S.C. 5465(e)(1).

<sup>2</sup> 17 CFR 240.19b-4(n)(1)(i).

<sup>3</sup> 15 U.S.C. 78a et seq.

<sup>4</sup> See Notice of Filing infra note 5, at 85 Fed. Reg. 49697.

<sup>5</sup> Securities Exchange Act Release No. 89515 (Aug. 10, 2020), 85 Fed. Reg. 49697 (Aug. 14, 2020) (File No. SR-OCC-2020-805) (“Notice of Filing”). On July 14, 2020, OCC also filed a related proposed rule change (SR-OCC-2020-008) with the Commission pursuant to Section 19(b)(1) of the Exchange Act and Rule 19b-4 thereunder (“Proposed Rule Change”). 15 U.S.C. 78s(b)(1) and 17 CFR 240.19b-4, respectively. In the Proposed Rule Change, which was published in the Federal Register on July 30, 2020, OCC seeks approval of proposed changes to its rules

received no comments regarding the changes proposed in the Advance Notice.<sup>6</sup> The Commission is hereby providing notice of no objection to the Advance Notice.

## II. BACKGROUND<sup>7</sup>

OCC serves as the sole clearing agency for standardized U.S. securities options listed on Commission-registered national securities exchanges (“listed options”).<sup>8</sup> OCC also operates two programs under which it clears stock loan transactions (the “Stock Loan Programs”).<sup>9</sup> As described in more detail below, OCC proposes to align the timeframes for closing out the open stock loan and non-stock loan positions of a defaulting Clearing Member.

In the event of a Clearing Member default, OCC would close out the defaulting Clearing Member’s open positions, liquidate collateral, and deposit the proceeds from

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necessary to implement the Advance Notice. Securities Exchange Act Release No. 89393 (Jul. 24, 2020), 85 Fed. Reg. 45943 (Jul. 30, 2020) (File No. SR-OCC-2020-008). The comment period for the related Proposed Rule Change filing closed on August 20, 2020.

<sup>6</sup> Since the proposal contained in the Advance Notice was also filed as a proposed rule change, all public comments received on the proposal are considered regardless of whether the comments are submitted on the Proposed Rule Change or the Advance Notice.

<sup>7</sup> Capitalized terms used but not defined herein have the meanings specified in OCC’s Rules and By-Laws, available at <https://www.theocc.com/about/publications/bylaws.jsp>.

<sup>8</sup> See Securities Exchange Act Release No. 85121 (Feb. 13, 2019), 84 Fed. Reg. 5157 (Feb. 20, 2019) (File No. SR-OCC-2015-02).

<sup>9</sup> OCC’s two Stock Loan Programs are the “Stock Loan/Hedge Program” and the “Market Loan Program.” Under its Stock Loan/Hedge Program, OCC clears transactions initiated directly between Clearing Members on a bilateral basis. Under its Market Loan Program, OCC clears transactions initiated on either a broker-to-broker basis or anonymously through the matching of bids and offers.

such a close-out into a Liquidating Settlement Account.<sup>10</sup> Generally, OCC would seek to close out the defaulting Clearing Member's open positions through an auction conducted, before market open, on the day after a default occurs. Under its rules, however, OCC may also seek to close out open positions cleared under its Stock Loan Programs by instructing non-defaulting Clearing Member counterparties to the open position to execute buy-in or sell-out transactions by the end of the business day following the default.<sup>11</sup> In the event that a Clearing Member counterparty fails to execute buy-in or sell-out transactions as instructed, OCC would terminate the relevant stock loan positions based on end of day prices from the business day following the default. Pursuant to the Advance Notice, OCC proposes to change (1) the time by which buy-in or sell-out transactions for defaulted open stock loan positions must be executed and (2) the price at which OCC would terminate positions not closed out through the execution of buy-in or sell-out transactions.

*Current rules.* Under its Rule 2211 and Rule 2211A, OCC may instruct a Clearing Member who is a party to stock loan transactions with a defaulting Clearing Member to execute buy-in or sell-out transactions, as applicable, with respect to each open stock borrow or loan position of the defaulting Clearing Member.<sup>12</sup> Currently, a

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<sup>10</sup> See OCC Rule 1104; available at [https://www.theocc.com/getmedia/9d3854cd-b782-450f-bcf7-33169b0576ce/occ\\_rules.pdf](https://www.theocc.com/getmedia/9d3854cd-b782-450f-bcf7-33169b0576ce/occ_rules.pdf). See also Notice of Filing, 85 Fed. Reg. at 49698.

<sup>11</sup> “Buy-in” refers to a non-defaulting lender purchasing replacement stock. “Sell-out” refers to a non-defaulting borrower selling the loaned securities in order to recoup its collateral. See Notice of Filing, 85 Fed. Reg. at 49697, n. 4.

<sup>12</sup> See OCC Rules 2211 and 2211A. Typically, OCC issues such instructions on the day of default. See Notice of Filing, 85 Fed. Reg. at 49698.

Clearing Member so instructed is obligated to execute the required transactions and provide notice of such execution to OCC by the close of the business on the day following receipt of such an instruction. If a Clearing Member fails to execute buy-in or sell-out transactions as instructed, OCC may terminate the relevant stock loan transactions. OCC would terminate such transactions based on prices from the end of the day after OCC issued buy-in or sell-out instructions (i.e., the same day by which the Clearing Member was obligated to execute the buy-in or sell-out transactions).

*Proposed change to execution time.* OCC proposes to amend its Rules 2211 and 2211A with regard to the time by which a Clearing Member must execute buy-in or sell-out transactions and provide notice to OCC of such transactions. OCC would continue to require that such transactions be executed by or before the business day following receipt of the instruction to execute such transaction. OCC proposes, however, to move up the time by which the transaction must be executed from the close of business to “settlement time,” which OCC’s current rules define as 9:00 a.m. Central Time.<sup>13</sup>

OCC considered requiring the execution of buy-in or sell-out transaction by the close of business on the day it instructed a Clearing Member to execute such transactions; however, Clearing Members expressed a preference for setting the deadline at 9:00 a.m. Central Time the following business day because doing so would allow a non-defaulting Clearing Member the opportunity to trade at market opening.<sup>14</sup> Because OCC typically issues buy-in or sell-out instructions on the day of default, the proposed

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<sup>13</sup> See By-Law Article I, Section 1.S.(16); available at [https://www.theocc.com/getmedia/3309eceb-56cf-48fc-b3b3-498669a24572/occ\\_bylaws.pdf](https://www.theocc.com/getmedia/3309eceb-56cf-48fc-b3b3-498669a24572/occ_bylaws.pdf).

<sup>14</sup> See Notice of Filing, 85 Fed. Reg. at 49698-99.

rule would require such transactions to be executed by 9:00 a.m. Central Time on the business day following the default. The required transactions would, therefore, be executed on the same day on which OCC seeks to close out a defaulting Clearing Member's other positions through its auction procedures. OCC believes allowing non-defaulting Clearing Members to trade at market opening on the morning following default would provide additional time to execute the buy-in and sell-out transactions in a manner consistent with OCC's two-day liquidation assumption.<sup>15</sup> The proposed change would provide OCC with authority under its rules to compel execution of buy-in or sell out transactions designed to close out a defaulting Clearing Member's stock loan positions at a point in time closer to OCC's other default management processes (i.e., auctions) than is currently permitted under OCC's rules.

*Proposed change to termination price.* OCC also proposes to amend its Rules 2211 and 2211A with regard to the price on which termination of stock loan positions would be based if a Clearing Member fails to execute buy-in or sell-out transactions within the required timeframes. Under the proposal, OCC would close out such positions based on end-of-day prices from the same day on which OCC instructed the Clearing Member to execute buy-in or sell-out transactions (i.e., the day before the Clearing Member was obligated to execute the buy-in or sell-out transactions).<sup>16</sup> Such a

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<sup>15</sup> See Notice of Filing, 85 Fed. Reg. at 49699.

<sup>16</sup> For example, OCC might rely on such end-of-day prices if Clearing Members were unable to execute buy-in or sell-out transactions to terminate open stock loan positions during the morning of the business day following the default because of circuit breaker activity. The use of the end-of-day prices from the day of default, as opposed to end-of-day prices following a full day of trading, would provide

price would be the last settlement price captured in OCC's systems prior to the time by which the non-defaulting Clearing Member was required to execute buy-in or sell-out transactions.<sup>17</sup> OCC believes that using such a price, already available in its system, would be superior to other options because it would allow for an automated process not susceptible to the delays and errors of manually pulling price information.<sup>18</sup>

### **III. COMMISSION FINDINGS AND NOTICE OF NO OBJECTION**

Although the Clearing Supervision Act does not specify a standard of review for an advance notice, the stated purpose of the Clearing Supervision Act is instructive: to mitigate systemic risk in the financial system and promote financial stability by, among other things, promoting uniform risk management standards for SIFMUs and strengthening the liquidity of SIFMUs.<sup>19</sup>

Section 805(a)(2) of the Clearing Supervision Act authorizes the Commission to prescribe regulations containing risk management standards for the payment, clearing, and settlement activities of designated clearing entities engaged in designated activities for which the Commission is the supervisory agency.<sup>20</sup> Section 805(b) of the Clearing Supervision Act provides the following objectives and principles for the Commission's

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closer alignment of market conditions for OCC's auction and stock loan terminations than the current rules.

<sup>17</sup> See Notice of Filing, 85 Fed. Reg. at 49698.

<sup>18</sup> See id.

<sup>19</sup> See 12 U.S.C. 5461(b).

<sup>20</sup> 12 U.S.C. 5464(a)(2).

risk management standards prescribed under Section 805(a):<sup>21</sup>

- to promote robust risk management;
- to promote safety and soundness;
- to reduce systemic risks; and
- to support the stability of the broader financial system.

Section 805(c) provides, in addition, that the Commission’s risk management standards may address such areas as risk management and default policies and procedures, among other areas.<sup>22</sup>

The Commission has adopted risk management standards under Section 805(a)(2) of the Clearing Supervision Act and Section 17A of the Exchange Act (the “Clearing Agency Rules”).<sup>23</sup> The Clearing Agency Rules require, among other things, each covered clearing agency to establish, implement, maintain, and enforce written policies and procedures that are reasonably designed to meet certain minimum requirements for its operations and risk management practices on an ongoing basis.<sup>24</sup> As such, it is appropriate for the Commission to review advance notices against the Clearing Agency Rules and the objectives and principles of these risk management standards as described

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<sup>21</sup> 12 U.S.C. 5464(b).

<sup>22</sup> 12 U.S.C. 5464(c).

<sup>23</sup> 17 CFR 240.17Ad-22. See Securities Exchange Act Release No. 68080 (Oct. 22, 2012), 77 Fed. Reg. 66220 (Nov. 2, 2012) (S7-08-11). See also Covered Clearing Agency Standards, 81 Fed. Reg. 70786. The Commission established an effective date of December 12, 2016 and a compliance date of April 11, 2017 for the Covered Clearing Agency Standards. OCC is a “covered clearing agency” as defined in Rule 17Ad-22(a)(5).

<sup>24</sup> 17 CFR 240.17Ad-22.

in Section 805(b) of the Clearing Supervision Act. As discussed below, the Commission believes the changes proposed in the Advance Notice are consistent with the objectives and principles described in Section 805(b) of the Clearing Supervision Act,<sup>25</sup> and in the Clearing Agency Rules, in particular Rule 17Ad-22(e)(13).<sup>26</sup>

**A. Consistency with Section 805(b) of the Clearing Supervision Act**

The Commission believes that the proposal contained in OCC's Advance Notice is consistent with the stated objectives and principles of Section 805(b) of the Clearing Supervision Act. Specifically, as discussed below, the Commission believes that the changes proposed in the Advance Notice are consistent with promoting robust risk management, promoting safety and soundness, reducing systemic risks, and supporting the stability of the broader financial system.<sup>27</sup>

The Commission believes that the proposed changes are consistent with promoting robust risk management, in particular the management of risks arising out of a Clearing Member default, as well as promoting safety and soundness. As a central counterparty and SIFMU,<sup>28</sup> it is imperative that OCC maintain default management processes designed to contain losses. As described above, OCC may, in the event of a Clearing Member default, seek to close out stock loan positions by requiring Clearing

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<sup>25</sup> 12 U.S.C. 5464(b).

<sup>26</sup> 17 CFR 240.17Ad-22(e)(13).

<sup>27</sup> 12 U.S.C. 5464(b).

<sup>28</sup> See Financial Stability Oversight Council ("FSOC") 2012 Annual Report, Appendix A, available at <https://www.treasury.gov/initiatives/fsoc/Documents/2012%20Annual%20Report.pdf>.

Members to execute buy-in or sell-out transactions while closing out non-stock loan positions and liquidating collateral via an auction. Pursuant to the Advance Notice, OCC proposes to more closely align the timeframe within which buy-in and sell-out transactions would occur with the timeframe of a default auction. In the event that such transactions do not occur within the required timeframes, OCC further proposes to terminate such stock loan transactions based on end of day prices from the same day on which OCC instructed the Clearing Member to execute buy-in or sell-out transactions. Such prices would likely represent the last market price received before OCC would auction off the rest of the defaulting Clearing Member's portfolio prior to the market open on the following morning. Aligning the timeframes for closing out stock loan positions and non-stock loan positions and collateral would reduce the potential for significant market movements occurring between the time by which OCC closes out positions and liquidates collateral related to such positions. Avoiding the potential for such market movements would, in turn, increase the likelihood that such collateral would be sufficient to mitigate losses arising out of the close out of stock loan positions. As such, the Commission believes that the proposal would promote robust risk management practices at, and the safety and soundness of, OCC, consistent with Section 805(b) of the Clearing Supervision Act.<sup>29</sup>

The Commission also believes that the changes proposed in the Advance Notice are consistent with reducing systemic risks and promoting the stability of the broader financial system. As noted above, OCC is the sole registered clearing agency for the U.S. listed options markets and a SIFMU. By aligning OCC's default management practices,

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<sup>29</sup> 12 U.S.C. 5464(b).

the Commission believes that the proposed changes would enhance OCC's ability to address events of Clearing Member default, thereby increasing the likelihood that OCC could liquidate a defaulting Clearing Member's portfolio without realizing severe credit losses. Such losses, if realized, could be mutualized through OCC's Clearing Fund, potentially during a period of market stress. While unavoidable under certain circumstances, reducing the probability of loss mutualization during periods of market stress could reduce the transmission of financial risks arising from a Clearing Member default to non-defaulting Clearing Members, their customers, and the broader options market. The Commission believes that the potential to avoid such severe credit losses would, therefore, reduce systemic risk and support the broader financial system. As such, the Commission believes the proposed changes are consistent with reducing systemic risks and promoting the stability of the broader financial system as contemplated in Section 805(b) of the Clearing Supervision Act.<sup>30</sup>

Accordingly, and for the reasons stated above, the Commission believes the changes proposed in the Advance Notice are consistent with Section 805(b) of the Clearing Supervision Act.<sup>31</sup>

**B. Consistency with Rule 17Ad-22(e)(13) under the Exchange Act**

Rule 17Ad-22(e)(13) under the Exchange Act requires that a covered clearing agency establish, implement, maintain, and enforce written policies and procedures reasonably designed to ensure the covered clearing agency has the authority and

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<sup>30</sup> 12 U.S.C. 5464(b).

<sup>31</sup> 12 U.S.C. 5464(b).

operational capacity to take timely action to contain losses and liquidity demands and continue to meet its obligations.<sup>32</sup>

As described above OCC, proposes to use its authority to alter the time when OCC will close out a defaulting Clearing Member's open stock loan positions. The proposed change would move the point in time by which OCC can close out open stock loan positions closer to the point in time by which OCC would seek to close the defaulting Clearing Member's non-stock loan positions and liquidate the defaulting Clearing Member's collateral via an auction. Aligning the timeframes for closing out stock loan positions and non-stock loan positions and collateral would reduce the potential for significant market movements occurring between the time by which OCC closes out positions and liquidates collateral related to such positions. Avoiding the potential for such market movements would, in turn, increase the likelihood that such collateral would be sufficient to mitigate losses arising out of the close out of stock loan positions.

OCC also proposes to terminate stock loan positions not closed out through buy-in or sell-out transactions based on end of day prices from the same day on which OCC instructed the Clearing Member to execute buy-in or sell-out transactions. As described above, such prices would likely represent the last market price received before OCC would auction off the rest of the defaulting Clearing Member's portfolio prior to the market open on the following morning. Similar to the change in the time by which Clearing Members would be instructed to execute buy-in or sell-out transactions, the proposed change in termination price would mitigate losses arising out of the close out of

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<sup>32</sup> 17 CFR 240.17Ad-22(e)(13).

open stock loan positions by reducing the potential for significant market movements between the close out of positions and liquidation of related collateral. Taken together, the Commission believes that proposed changes regarding the close out a defaulting Clearing Member's open stock loan positions would enhance OCC's authority to take timely action to contain losses.

Accordingly, the Commission believes that Advance Notice would be consistent with Rule 17Ad-22(e)(13) under the Exchange Act.<sup>33</sup>

#### **IV. CONCLUSION**

IT IS THEREFORE NOTICED, pursuant to Section 806(e)(1)(I) of the Clearing Supervision Act, that the Commission DOES NOT OBJECT to Advance Notice (SR-OCC-2020-805) and that OCC is AUTHORIZED to implement the proposed change as of the date of this notice or the date of an order by the Commission approving proposed rule change SR-OCC-2020-008 whichever is later.

By the Commission.

J. Matthew DeLesDernier  
Assistant Secretary

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<sup>33</sup> 17 CFR 240.17Ad-22(e)(13).