

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹²

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Assistant Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-80537; File No. SR-OCC-2017-802]

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of No Objection To Advance Notice Filing Concerning the Options Clearing Corporation's Enhancements to OCC's Stock Loan Programs

April 27, 2017.

The Options Clearing Corporation ("OCC") filed on February 28, 2017 with the Securities and Exchange Commission ("Commission") advance notice SR-OCC-2017-802 ("Advance Notice") pursuant to Section 806(e)(1) of the Payment, Clearing, and Settlement Supervision Act of 2010 ("Payment, Clearing and Settlement Supervision Act")¹ and Rule 19b-4(n)(1)(i) under the Securities Exchange Act of 1934² ("Exchange Act") to propose a number of enhancements to its Stock Loan/Hedge Program ("Hedge Program") and Market Loan Program (collectively, the "Stock Loan Programs"). The proposed changes would supplement OCC's risk management framework for the Stock Loan Programs to provide greater certainty concerning each participant's stock loan exposures and to mitigate risks that may arise in the event of a clearing member suspension. The Advance Notice was published for comment in the **Federal Register** on April 3, 2017.³ The Commission has not

received any comments on the Advance Notice to date. This publication serves as notice of no objection to the Advance Notice.

I. Background

OCC operates two Stock Loan Programs—the Hedge Program and Market Loan Program—in which a participating clearing member can lend an agreed-upon number of shares of eligible stock⁴ to another clearing member in exchange for an agreed-upon value of U.S. dollar cash collateral and then novate the loan to OCC for clearing.⁵ The Hedge Program permits clearing members to bilaterally execute stock loans and negotiate collateralization and other terms before submitting such stock loans to OCC for novation and clearing.⁶ The Market Loan Program is operationally similar to the Hedge Program, but it permits clearing members to execute stock loans through a multilateral loan market.⁷ In each case, upon completion of the novation process, OCC, in its capacity as a central counterparty, guarantees return of (i) loaned stock, or that stock's value, to the lending clearing member, and (ii) the value of cash collateral to the borrowing clearing member.⁸ In addition, OCC makes mark-to-market margin payments on a daily basis to ensure stock loans remain fully collateralized.

II. Description of the Advance Notice

OCC's Advance Notice proposes a number of changes to the Stock Loan Programs and its Rules governing those Programs.⁹ First, to improve trade

certainty and transparency concerning clearing member exposures, OCC proposes amendments to its rules governing the Stock Loan Programs to do the following: (1) Require clearing members to have policies and procedures to reconcile stock loan positions each business day; (2) state explicitly that the controlling record for stock loan positions for margin and other purposes is OCC's "golden" record; and (3) provide that stock loan positions remain in effect until OCC's records reflect stock loan terminations. Second, to mitigate risks that may arise in the event of a clearing member suspension, OCC proposes amendments to its rules governing the Stock Loan Programs to do the following: (1) Provide a two-day trading window in which clearing members must execute close-out transactions, also known as "buy-in" or "sell-out" transactions; (2) provide broad authority for OCC to use reasonable prices to settle close-out transactions; and (3) permit OCC to close out and re-establish the matched-book stock loan positions of a suspended Hedge Program clearing member through termination by offset and "re-matching" with other clearing members. Each of these proposals is discussed in more detail below.

A. Proposed Measures To Improve Trade Certainty and Transparency

OCC's Advance Notice proposes three amendments to the rules governing its Stock Loan Programs that are intended to improve trade certainty and transparency for clearing members and OCC.

1. Daily Reconciliation of Stock Loan Positions

Clearing members that participate in the Hedge Program and the Market Loan Program execute and terminate stock loans on a bilateral basis. Following execution or termination of stock loans, OCC requires clearing members to promptly report stock loans directly to OCC, or to facilitate such reporting to OCC through the Depository Trust Corporation ("DTC"), ensuring OCC accepts stock loans for clearing and records the novation or termination for margin and other purposes. Under the current trade-reporting process, clearing members may fail to report (or to have DTC report) stock loans to OCC in a timely manner, increasing uncertainty in the novation process and decreasing transparency with respect to OCC's stock loan positions and obligations as a central counterparty and guarantor. The current process thereby presents risk management risks both to OCC and clearing members.

and has not received any comments on the proposal to date. See Securities Exchange Act Release No. 34-80323 (March 8, 2017), 82 FR 13690 (March 14, 2017) (File No. SR-OCC-2017-002).

⁴ See OCC Rules 2202 and 2202A (providing that stock loans under the Hedge Program and the Market Loan Program, respectively, must effect transfer only of "Eligible Stock," as defined in Article I of OCC's By-Laws). OCC permits clearing members to execute stock loans involving 6,191 eligible securities as March 29, 2017, available at <https://www.theocc.com/webapps/stock-loan-eligible-securities>.

⁵ The Hedge Program is governed by Article XXI of OCC's By-Laws and Chapter XXII of OCC's Rules. The Market Loan Program is governed by Article XXIA of OCC's By-Laws and Chapter XXIIA of OCC's Rules. The Commission understands that OCC cleared approximately 10–15% of the overall U.S.-equities stock loan market through the two programs, as of November 2015.

⁶ The Commission understands that the Hedge Program accounts for approximately 95% of cleared stock loan volume at OCC, as of November 2015.

⁷ Automated Equity Finance Markets, Inc. is the sole loan market through which clearing members can execute stock loans in the Market Loan Program.

⁸ See OCC Rules 2202(b) and 2202A(b).

⁹ For a more detailed description of the specific rule changes OCC is proposing, see Notice of Filing of Advance Notice, *supra* note 3.

¹² 17 CFR 200.30-3(a)(12).

¹ 12 U.S.C. 5465(e)(1). The Financial Stability Oversight Council designated OCC a systemically important financial market utility ("SIFMU") on July 18, 2012. See Financial Stability Oversight Council 2012 Annual Report, Appendix A, <http://www.treasury.gov/initiatives/fsoc/Documents/2012%20Annual%20Report.pdf>. Therefore, OCC is required to comply with the Payment, Clearing and Settlement Supervision Act and file advance notices with the Commission.

² 17 CFR 240.19b-4(n)(1)(i).

³ See Securities Exchange Act Release No. 34-80323 (March 28, 2017), 82 FR 16260 (April 3, 2017) (File No. SR-OCC-2017-802) ("Notice of Filing of Advance Notice"). OCC also filed a proposed rule change with the Commission pursuant to Section 19(b)(1) of the Securities Exchange Act ("Exchange Act") and Rule 19b-4 thereunder, seeking approval of changes to its rules necessary to implement the Advance Notice. 15 U.S.C. 78s(b)(1) and 17 CFR 240.19b-4, respectively. The Commission published notice of the proposed rule change in the **Federal Register**

To address these risk management risks, OCC proposes to require each clearing member to have adequate policies and procedures to perform daily reconciliations of stock loan positions against OCC's records and to resolve stock loan discrepancies, if any, by 9:30 a.m. Central Time the following business day.¹⁰ These proposed rule changes, according to OCC, would improve trade certainty and transparency for clearing members participating in the Hedge Program and the Market Loan Program and thereby reduce operational and other risks for OCC and clearing members.

2. Controlling Records for Open and Terminated Stock Loan Positions

To support and supplement the proposed daily reconciliation requirements for clearing member participation in the Stock Loan Programs, OCC proposes to explicitly state in its rules that OCC's stock loan records constitute the controlling records for margin and other purposes. Specifically, the proposed rules would specify that OCC's records, which OCC refers to as the "golden copy" records, prevail in the event of a conflict with clearing member records and that clearing members must continue to perform on obligations relating to open stock loan positions identified in the golden copy records.¹¹ The proposed rules, according to OCC, support trade certainty and transparency in the Hedge and Market Loan Programs.

3. Termination Records for Stock Loan Positions

Finally, to conform OCC's stock loan termination provisions to the proposed changes relating to controlling records described above, OCC proposes rule changes to clarify that stock loans would be considered terminated for margin and other purposes only when OCC's records reflect termination of the stock loan.¹² OCC states that these conforming changes also would support trade certainty and transparency in the Stock Loan Programs by ensuring consistency among and within the different rules applicable to the Stock Loan Programs.

B. Proposed Measures To Mitigate Stock Loan Risks in the Event of a Clearing Member Suspension

In addition to the proposals intended to improve trade certainty and transparency, the Advance Notice also proposes three amendments to address certain risks that may arise in the event that OCC suspends a clearing member participant in the Stock Loan Programs.

1. Stock Loan Close-Out Timeframe in the Event of a Clearing Member Suspension

Under current Stock Loan Program rules, OCC may seek to close out a suspended clearing member's stock loan positions by instructing non-suspended clearing member counterparties to execute close-out transactions within a reasonable period of time.¹³ Although non-suspended clearing members must be prepared to defend the timeliness of close-out transactions under current rules, clearing members are not required to execute close-out transactions based on OCC's instructions within a specific period of time. Accordingly, if non-suspended clearing members execute buy-in or sell-out transactions over an extended period of time following OCC's close-out instruction, OCC incurs a risk that close-out prices may vary significantly from the prices used to mark the stock loan positions to market for margin purposes. OCC's credit exposure, in part, depends on the significance of these price differences relative to the suspended clearing member's available margin resources.

To mitigate these risks, OCC proposes to require clearing members to execute close-out transactions within a fixed two-day trading window in the event of a clearing member suspension. More specifically, OCC proposes to require non-suspended clearing members to execute close-out transactions by the end of the business day following OCC's instruction to close out stock loans with the suspended clearing member. If a non-suspended clearing member is unable to execute the close-out transactions within that two-day timeframe, OCC itself would terminate the clearing member's relevant stock loans and effect settlement based on the market price of the underlying securities, as determined by OCC. According to OCC, the proposed changes are intended to ensure that non-suspended clearing members execute

close-out transactions in a timeframe consistent with OCC's two-day liquidation assumption for stock loan margin purposes, which should reduce OCC's credit exposure from significant differences between clearing member-effectuated close-out prices and the prices used to collect mark-to-market payments from the suspended clearing member.

2. Reasonable Prices for Stock Loan Close-Out Transactions in the Event of a Clearing Member Suspension

Under current rules, OCC may seek to close out a suspended clearing member's stock loan positions by instructing non-suspended clearing member counterparties to execute buy-in or sell-out transactions. These close-out transactions must be executed in a "commercially reasonable manner."¹⁴ If a borrowing clearing member is suspended and unable to return securities under a stock loan, OCC may instruct the lending clearing member to execute a "buy-in" transaction for the number of shares in the stock loan's underlying security that would be necessary to return the lending clearing member to its position prior to entering into the stock loan with the suspended clearing member. If the lending clearing member is suspended and unable to return the value of collateral, OCC similarly may instruct the borrowing clearing member to execute a "sell-out" transaction for the number of shares in the underlying security that would be necessary to return the borrowing clearing member to its position prior to entering into the stock loan. In each case, the non-suspended clearing member's stock loan position is terminated and settled based on the price reported for the close-out transaction.

To incentivize "reasonable" pricing of close-out transactions in the event of a clearing member suspension, OCC proposes to provide itself authority to withdraw from a clearing member's account the value of any difference between clearing member-reported prices and "reasonable" close-out transaction prices, as determined by OCC based on an assessment of market conditions at the time of execution.¹⁵

¹⁴ *Id.*

¹⁵ See Proposed Rule 2211. The proposal provides that a clearing member may demonstrate that a close-out transaction was executed at a "reasonable" price by providing evidence that the transaction fell within the underlying stock's trading range on the date of execution. *Id.* To the extent a clearing member impacts the market price of an underlying security through close-out transactions, OCC, in its discretion, may consider such impact in its assessment of market conditions at the time of execution.

¹⁰ See Proposed Rule 2205 of the Hedge Program and Proposed Rule 2205A of the Market Loan Program.

¹¹ See Proposed Articles XXI and XXIA of OCC's By-Laws.

¹² See Proposed Rule 2209 in the Hedge Program and Proposed Rule 2209A in the Market Loan Program.

¹³ More specifically, Rules 2209(b) and (f) and 2211 of the Hedge Program, and Rules 2209A(b) and (c) and 2211A of the Market Loan Program require clearing members to execute close-out transactions in a "commercially reasonable manner" and to be prepared to defend the timing, prices, and costs of such transactions.

This proposed price-substitution authority, according to OCC, would incentivize non-suspended clearing members to execute and report close-out transactions in a commercially reasonable manner.¹⁶

3. Re-Matching in the Event of a Hedge Clearing Member Suspension

Under OCC's current rules, in the event of a clearing member suspension, OCC can fully unwind a suspended Hedge Clearing Member's matched-book positions¹⁷ only if it recalls all borrowed securities from specific borrowing clearing members and returns those securities to specific lending clearing members. Under current rules, this recall-and-return process is operationally complex because the nature of these unwinds would require OCC to (i) effect transfer of significant numbers of securities to significant numbers of non-suspended clearing members; and (ii) settle an equal number of payments against final settlement prices. Moreover, during this recall-and-return process, the non-suspended clearing members may experience unexpected imbalances in their overall stock loan positions, resulting in increased margin requirements or price risks relating to re-execution of the stock loans in a potentially distressed market.¹⁸

To address these operational complexities and the potential consequences for both OCC and its clearing members, OCC proposes new rules that would permit it to terminate a suspended Hedge Clearing Member's matched-book stock loans in the Hedge Program by offset and to "re-match" the positions of the non-suspended counterparties according to priorities established by OCC's matching algorithm.¹⁹ According to OCC, re-

matching stock loans pursuant to an algorithm would facilitate orderly and efficient termination and re-establishment of stock loans involving a suspended Hedge Clearing Member, thereby mitigating operational and pricing risks that may arise for non-suspended clearing members during the recall-and-return process.

III. Discussion and Commission Findings

Although the Payment, Clearing and Settlement Supervision Act does not specify a standard of review for an advance notice, the stated purpose of the Payment, Clearing and Settlement Supervision Act is instructive.²⁰ The stated purpose of the Payment, Clearing and Settlement Supervision Act is 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.²¹

Section 805(a)(2) of the Payment, Clearing and Settlement Supervision Act²² 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. Section 805(b) of the Payment, Clearing and Settlement Supervision Act²³ provides the following objectives and principles for the Commission's risk management standards prescribed under Section 805(a):

- 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 others areas.²⁴

The Commission has adopted risk management standards under Section 805(a)(2) of the Payment, Clearing and Settlement Supervision Act and the Exchange Act (the "Clearing Agency Rules").²⁵ The Clearing Agency Rules

require each covered clearing agency, among other things, to establish, implement, maintain, and enforce written policies and procedures that are reasonably designed to meet certain minimum requirements for operations and risk management practices on an ongoing basis. As such, it is appropriate for the Commission to review advance notices for consistency with the objectives and principles for risk management standards described in Section 805(b) of the Payment, Clearing and Settlement Supervision Act and the Clearing Agency Rules.

A. Consistency With Section 805(b) of the Payment, Clearing and Settlement Supervision Act

The Commission believes each proposal in OCC's Advance Notice is consistent with promoting robust risk management, promoting safety and soundness, reducing systemic risks, and supporting the stability of the broader financial system, the stated objectives and principles of Section 805(b) of the Payment, Clearing and Settlement Supervision Act.²⁶

First, the Commission believes that OCC's three proposals to improve trade certainty and transparency in the Stock Loan Programs are consistent with promoting robust risk management. The Commission agrees with OCC's analysis that its proposal to require clearing members to implement adequate policies and procedures to reconcile stock loan positions with OCC's records on a daily basis could promote robust risk management by reducing financial and other risks to OCC and clearing members. The Commission also believes that OCC's proposal to provide explicitly in its rulebook that its stock loan records would prevail in the event of a conflict with clearing member records, and that clearing members must continue to perform on all stock loan positions reflected in OCC's records also promotes robust risk management by encouraging clearing members to understand, manage, and promptly report stock loan transactions. Finally, the Commission believes that OCC's proposal to provide that stock loan positions remain in effect until OCC's records reflect stock loan terminations promotes robust risk management by

Standards"). The Commission established an effective date of December 12, 2016, and a compliance date of April 11, 2017, for the Covered Clearing Agency Standards. On March 4, 2017, the Commission granted covered clearing agencies a temporary exemption from compliance with Rule 17Ad-22(e)(3)(ii) and certain requirements in Rules 17Ad-22(e)(15)(i) and (ii) until December 31, 2017, subject to certain conditions. OCC is a "covered clearing agency" as defined in Rule 17Ad-22(a)(5).

²⁶ 12 U.S.C. 5464(b).

¹⁶ If the close-out transaction is not executed within the two-day period provided in Proposed Rule 2212, however, the stock loan would be terminated and settled based on OCC's marking price at the end of the period.

¹⁷ See definition of "Matched-Book Positions" in Article I of OCC's By-laws. A clearing member that maintains a "matched book" for stock loans generally borrows no more of a specific security than it lends to other clearing members in the program. See also Notice of Filing of the Advance Notice, *supra* note 3 at 9.

¹⁸ OCC's present margin methodology nets matched-book stock loan positions prior to calculating clearing member exposures. Thus, a non-suspended clearing member's margin requirements may increase on account of the temporary stock loan imbalances resulting from a clearing member suspension.

¹⁹ OCC's matching algorithm would implement priorities in OCC's Proposed Rule 2212(d), which establishes an order of operations based on the size of stock loan positions and the existence of master securities lending agreements between the non-suspended clearing members.

²⁰ See 12 U.S.C. 5461(b).

²¹ *Id.*

²² 12 U.S.C. 5464(a)(2).

²³ 12 U.S.C. 5464(b).

²⁴ 12 U.S.C. 5464(c).

²⁵ 17 CFR 240.17Ad-22. See Securities Exchange Act Release No. 68080 (October 22, 2012), 77 FR 66220 (November 2, 2012) (S7-08-11). See also Securities Exchange Act Release No. 78961 (September 28, 2016), 81 FR 70786 (October 13, 2016) (S7-03-14) ("Covered Clearing Agency

emphasizing that OCC's records supersede the records of clearing members and further encouraging clearing members to understand, manage, and promptly report stock loan transactions. The Commission therefore believes these specific proposals are consistent with promoting robust risk management.

Second, the Commission believes that OCC's three proposals to mitigate certain risks in the event of a clearing member suspension are consistent with promoting robust risk management. The proposal to provide a two-day trading window in which clearing members must execute close-out transactions, or opt for mandatory settlement, promotes robust risk management by requiring non-suspended clearing members to complete close-out transactions in a timeframe that is consistent with OCC's liquidation assumptions. The proposed alignment of the close-out period with OCC's liquidation assumptions reduces the risk that close-out prices vary too significantly from the prices used to mark the suspended clearing member's stock loans to market. OCC's proposed price-substitution authority also promotes robust risk management by further encouraging non-suspended clearing members to execute close-out transactions in a commercially reasonable manner, thereby reducing financial risk to OCC. Finally, the proposed rule changes in the Hedge Program to permit OCC to terminate and re-establish a suspended clearing member's positions through offset and "re-match" promotes robust risk management by facilitating orderly and efficient termination and re-establishment of stock loans involving a suspended clearing member, which mitigates operational and pricing risks that may arise for OCC and clearing members during the recall-and-return process. The Commission therefore believes that these aspects of the proposal are consistent with the promotion of robust risk management.

Based on the conclusions discussed above, the Commission also believes that OCC's proposal is consistent with promoting the safety and soundness of both OCC and clearing members who participate in the Stock Loan Programs. Accordingly, because promoting the safety and soundness of both OCC and clearing members who participate in the Stock Loan Programs, in turn, both reduces systemic risks that may arise from clearing member participation in these programs and supports the stability of the broader financial system, the Commission also believes that the proposals contained in the Advance Notice are consistent with the stated

objectives and principles of Section 805(b) of the Payment, Clearing and Settlement Supervision Act.

B. Consistency With Rules 17Ad-22(e)(13) and (e)(23) Under the Exchange Act

The Commission believes OCC's proposals in the Advance Notice are consistent with Covered Clearing Agency Standards, specifically Rules (e)(13) and (e)(23) under the Exchange Act.²⁷ Rule 17Ad-22(e)(13) under the Exchange Act requires each covered clearing agency to establish, implement, maintain, and enforce policies and procedures reasonably designed to, among other things, ensure it has the authority and operational capacity to take timely action to contain losses and continue to meet its obligations in the event of a clearing member default.²⁸ More generally, Rule 17Ad-22(e)(23) under the Exchange Act requires covered clearing agencies to establish, implement, maintain, and enforce policies and procedures reasonably designed to, among other things, provide for the public disclosure of all relevant rules and material procedures, including key aspects of default rules and procedures.²⁹

The Commission believes the proposed changes relating to clearing member suspension in OCC's Advance Notice are consistent with Rule 17Ad-22(e)(13) under the Exchange Act. By proposing a fixed trading window in which clearing members must either execute close-out transactions relating to a clearing member suspension or opt for OCC-mandated settlements, OCC is seeking new authority that the Commission believes will better ensure that OCC can take timely actions to contain suspension-related losses and continue to meet stock loan-related obligations in the Stock Loan Programs. The Commission further believes that the proposed authority permitting OCC to withdraw the value of any difference between the clearing member-reported prices and OCC-determined close-out prices likewise better ensures that OCC can contain suspension-related losses, as clearing members would be further incentivized to execute timely close-out transactions at market prices. Finally, the Commission believes that the proposal relating to re-matching-in-suspension better ensures that OCC has authority and operational capacity to contain losses and meet obligations to clearing members in the Hedge Program,

in particular through new rules and mechanisms that reduce the operational, credit, and re-execution risks attendant to the recall-and-return process. The Commission therefore believes OCC's proposal is consistent with Rule 17Ad-22(e)(13) under the Exchange Act.

The Commission also believes that OCC's proposals are consistent with Rule 17Ad-22(e)(23) under the Exchange Act. Each aspect of OCC's Advance Notice is proposed to be disclosed publicly in OCC's rules governing the Stock Loan Programs, including the key suspension-related aspects of its rules providing for close-out transaction timeframes, new price-substitution authority, and termination and re-matching-in-suspension. The Commission therefore believes that OCC's proposal is consistent with Rules 17Ad-22(e)(23) under the Exchange Act.

IV. Conclusion

It is therefore noticed, pursuant to Section 806(e)(1)(G) of the Payment, Clearing and Settlement Supervision Act,³⁰ that the Commission *does not object* to Advance Notice (SR-OCC-2017-802) and that OCC is *authorized* to implement the proposed change.

By the Commission.

Eduardo A. Aleman,
Assistant Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-80545; File No. SR-IEX-2017-03]

Self-Regulatory Organizations; Investors Exchange LLC; Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 1, To Amend IEX Rule 16.135 To Adopt Generic Listing Standards for Managed Fund Shares

April 27, 2017.

I. Introduction

On January 19, 2017, Investors Exchange LLC ("IEX" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² a proposed rule change to amend IEX Rule 16.135 to adopt generic listing standards for Managed Fund Shares. The proposed

²⁷ 17 CFR 240.17Ad-22(e)(13), and 17 CFR 240.17Ad-22(e)(23).

²⁸ 17 CFR 240.17Ad-22(e)(13).

²⁹ 17 CFR 240.17Ad-22(e)(23).

³⁰ 12 U.S.C. 5465(e)(1)(G).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.