For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[19]

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SECURITIES AND EXCHANGE COMMISSION

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Self-Regulatory Organizations; the Options Clearing Corporation; Notice of Filing of Proposed Rule Change Concerning Enhancements to OCC's Stock Loan Programs

March 8, 2017.

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 February 28, 2017, 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 by OCC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

This proposed rule change by OCC is designed to enhance the overall resilience of OCC's Stock Loan/Hedge Program (''Hedge Program'') and Market Loan Program (collectively, the ''Stock Loan Programs''). The proposed rule change would, among other things: (1) Require Clearing Members to have robust processes in place to reconcile open interest in the Stock Loan Programs at least once per stock loan business day; (2) provide further clarity and certainty regarding the formal record of stock loan positions being guaranteed by OCC at any given time (''golden copy'' rules); (3) further clarify that stock loan positions at OCC are not terminated until the records of OCC reflect the termination of such stock loan; (4) provide a specific timeframe in which Clearing Members in the Stock Loan Programs must buy-in or sell-out of stock loan positions in the event of another Hedge or Market Loan Clearing Member suspension (as applicable); (5) provide OCC with the authority to withdraw from a Clearing Member's account the value of any difference between the price reported by a Clearing Member instructed to execute a buy-in or sell-out of loaned stock as a result of another Clearing Member suspension and the price that OCC determines to be reasonable; and (6) allow OCC to close out the Matched-Book Positions of suspended Hedge Clearing Members 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 terms with initial capitalization not defined herein have the same meaning as set forth in OCC's By-Laws and Rules.[3]

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 a number of amendments to its By-Laws and Rules designed to enhance the overall resilience of its Stock Loan/Hedge Program (''Hedge Program'') and Market Loan Program (collectively, the ''Stock Loan Programs''). Specifically, the proposed rule change would improve risk management in the Stock Loan Programs by, among other things: (1) Requiring Clearing Members to have robust processes in place to reconcile open interest in the Stock Loan Programs at least once per stock loan business day; (2) providing further clarity and certainty regarding the formal record of stock loan positions being guaranteed by OCC at any given time (''golden copy'' rules); (3) further clarifying that stock loan positions at OCC are not terminated until the records of OCC reflect the termination of such stock loan; (4) providing a specific timeframe in which Clearing Members in the Stock Loan Programs must buy-in or sell-out of stock loan positions in the event of another Hedge or Market Loan Clearing Member suspension as applicable); (5) providing OCC with the authority to withdraw from a Clearing Member's account the value of any difference between the price reported by a Clearing Member instructed to execute a buy-in or sell-out of loaned stock as a result of another Clearing Member suspension and the price that OCC determines to be reasonable; and (6) allowing OCC to close out the Matched-Book Positions of suspended Hedge Clearing Members 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 amendments to the By-Laws and Rules are discussed in more detail below.

Background

OCC currently operates two Stock Loan Programs: The Hedge Program and the Market Loan Program. In the Hedge Program, OCC acts as the principal counterparty for stock loans that are executed bilaterally outside of OCC and sent to OCC for clearance and settlement. In the case of a Hedge Loan, prospective Lending and Borrowing Clearing Members identify each other (independent of OCC), agree to bilaterally negotiated terms of the Hedge Loan, and then send the details of the stock loan to the Depository with a certain ''reason code,'' [4] which designates the stock loan as a Hedge Loan for guaranty and clearance at OCC. The Lending Clearing Member then 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.

In the Market Loan Program, stock loans are initiated through the matching of bids and offers that are either agreed upon by the Market Loan Clearing Members or matched anonymously through a Loan Market. In order to initiate a Market Loan, the Loan Market sends a matched transaction to OCC, which in turn sends two separate but linked settlement instructions to the Depository to effect the movement of Eligible Stock and cash collateral between the accounts of the Market

[19] 17 CFR 200.30–3(a)(12).

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] OCC's By-Laws and Rules can be found on OCC's public Web site: *http://optionsclearing.com/about/publications/bylaws.jsp.*

[4] 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.

Loan Clearing Members through OCC's account at the Depository.

Regardless of whether a transaction is initiated under the Hedge Program or Market Loan Program, OCC novates the transaction and becomes the lender to the Borrowing Clearing Member and the borrower to the Lending Clearing Member after it accepts an end-of-day report from the Depository showing completed Stock Loans.[5] As the principal counterparty to the Borrowing and Lending Clearing Members, OCC guarantees the return of the full value of cash collateral to a Borrowing Clearing Member and guarantees the return of the Loaned Stock (or value of that Loaned Stock) to the Lending Clearing Member.[6] After novation, as part of the guaranty, OCC makes Mark-to-Market Payments for all cleared stock loans on a daily basis to collateralize all loans to the negotiated levels.[7] Settlements generally are combined and netted against other OCC settlement obligations in a Clearing Member's account, including trade premiums and margin deficits. Clearing Member open positions in the Stock Loan Programs are factored into the Clearing Member's overall Margin [8] and Clearing Fund contribution requirements.[9]

Stock Loan Position Records

OCC's Rules currently provide that termination of a Hedge Loan is not complete until either: (1) The Depository makes final entries on its records reflecting that the stock loan position has been unwound and OCC receives notice thereof; or (2) the counterparties to the transaction certify to OCC that the stock loan is terminated and the settlement price has been transferred between them.[10] Under this process, it is possible for a Hedge Clearing Member to close an open Hedge Loan but fail to submit the necessary reason codes to the Depository to effect the termination of the stock loan position at OCC, resulting in conflicting records between OCC and its Clearing Members.

Market Loans are typically terminated by a Market Loan Clearing Member providing notice to the relevant Loan Market calling for the recall or return of a specified quantity of the Loaned Stock. The Loan Market then sends details of the matched return/recall transaction to OCC, which validates the transaction and sends a pair of delivery orders to the Depository in connection with the recall/return. However, in certain circumstances where a Market Loan Clearing Member fails to return the specified quantity of Loaned Stock or to pay the applicable settlement price for a Loaned Stock, the counterparty Clearing Member may choose to execute a buy-in or sell-out of the Loaned Stock on its own.[11] The Market Loan Clearing Member is then required to provide notice to the Loan Market of the buy-in or sell-out after execution is complete. This limited scenario could also give rise to the risk that a Market Loan Clearing Member has terminated a stock loan transaction but failed to provide the necessary report to the Loan Market for notification to OCC.

When either of the above scenarios occur, the Clearing Member remains obligated to effect the required settlements, including, for example, making the associated Mark-to-Market Payments, until the stock loan position is terminated at OCC. Moreover, in these scenarios, a Clearing Member may continue to receive margin benefits on the closed stock loan until the appropriate trade corrections are made at OCC. Such scenarios could give rise to operational and/or credit risk if a Clearing Member's expectations of its obligations for certain stock loan positions are inconsistent with the Clearing Member's formal obligations for such positions on the records of OCC (*e.g.,* requirements to post margin or make mark-to-market settlements for positions that have already been closed).

Default Management in the Stock Loan Programs

Currently, in the event a Stock Loan Program Clearing Member is suspended, the suspended Clearing Member's open stock loan positions are closed by instructing the respective non-suspended Clearing Member counterparties (within either the Hedge Program or Market Loan Program, as applicable) to buy-in or sell-out the Eligible Stock.[12] The reported execution price of the buy-in or sell-out is used as the settlement price to facilitate the final marking price between the non-suspended Clearing Member and the liquidating settlement account of the suspended Clearing Member. This process has significant benefits as it distributes the liquidity demands across multiple counterparties and aligns the liquidity demands necessary to facilitate an unwind with the Clearing Member currently in possession of the Collateral. However, this approach effectively utilizes each counterparty to the suspended Clearing Member as independent ''liquidating agents,'' making the process prone to greater execution risk due to the number of counterparties effecting the buy-in/sell-out transactions, which is further compounded by the manually-intensive nature of the process. In the event a large Hedge or Market Loan Clearing Member is suspended, the process could become more susceptible to errors given the numerous manual steps and the quantity of positions that must be closed. Moreover, any delay in the buy-in/sell-out process could result in increased credit risk to OCC as the close out process for stock loans could fail to align with OCC's margin and liquidation period assumptions of a two-day close out process (which is applicable to all products without differentiation). For example, OCC may be exposed to credit risk if the price paid or received for the buy-in or sell-out of the Eligible Stock varies from the price at which OCC last collected a Mark-to-Market Payment from the defaulter and that price differential exceeds the amount of margin on deposit for such positions.

Furthermore, and as described in more detail below, because OCC maintains inventory in the Hedge Program on a bilateral basis (*i.e.,* maintains the borrower and lender to a given transaction) if a suspended Hedge Clearing Member maintains Matched-Book Positions,[13] logistically OCC would be required to recall the loan and return the borrowed shares to unwind the Matched-Book positions. This results in a potential exposure to OCC, not accounted for by its margin model,[14] related to the potential price dislocation

[5] *See* OCC Rules 2202(b) and 2202A(b).

[6] Under the Market Loan Program, OCC also provides a limited guaranty of dividend and rebate payments.

[7] Mark-to-Market Payments are based on the value of the loaned securities and made between Clearing Members using OCC's cash settlement system. In the Hedge Program, the percentage of the value of the loaned securities, either 100% or 102%, as well as the preferred Mark-to-Market rounding, are dependent upon the terms of the Master Securities Loan Agreement (''MSLA'') between the two Hedge Clearing Member parties to the transaction. In the Market Loan Program, all Market Loans are collateralized to 102%.

[8] *See* OCC Rules 601 and 2203.

[9] *See* OCC Rule 1001.

[10] *See* OCC Rule 2209(a) which describes the requirements for the termination of a stock loan transaction.

[11] *See* OCC Rule 2209A(b)–(c).

[12] *See* OCC Rules 2211 and 2211A.

[13] Matched-Book Positions are Hedge Loan positions in which a single Hedge Clearing Member borrows Eligible Stock from a Lending Clearing Member and lends an equal or lesser amount of the same Eligible Stock to a Borrowing Clearing Member. Previously, OCC adopted a proposed rule change to allow for the voluntary termination by offset and re-matching of Matched-Book Positions, outside of the suspension scenario, subject to the agreement of all affected Hedge Clearing Members. *See* Securities Exchange Act Release No. 34–77415 (March 22, 2016), 81 FR 17231 (March 28, 2016) (SR–OCC–2016–006).

[14] With Matched-Book Positions, a member is simultaneously borrowing and lending the same

Continued

between the recall and return transactions.

Proposed Changes to the By-Laws and Rules

OCC is proposing a number of rule changes to provide more clarity, transparency, and certainty around the status of stock loan positions being cleared and guaranteed at OCC. In addition, OCC is proposing enhancements to its default management process for the Stock Loan Programs to mitigate the risks associated with the buy-in/sell-out and recall/return processes as described above. The proposed changes are discussed in more detail below.

1. Trade Balancing

A key attribute of managing risk in the Stock Loan Programs is ensuring that OCC and its Clearing Members have identical records of open and closed positions to ensure all parties are aware of their obligations with respect to those positions. As described above, a stock loan transaction may be terminated by a Hedge Clearing Member (and, in more limited circumstances, a Market Loan Clearing Member) without OCC being made aware of the termination if the correct reason codes are not used in connection with stock loan activity at the Depository.[15] Such a discrepancy between the records of OCC and its Clearing Members could give rise to operational and/or credit risk if a Clearing Member's expectations of its obligations for certain stock loan positions are inconsistent with the Clearing Member's formal obligations for such positions on the records of OCC (see discussion of the proposed ''golden copy'' rules below).

In order to minimize the potential dislocation between the records of OCC and its Clearing Members and mitigate the risks that may arise from such out trades, OCC is proposing to amend Rules 2205 and 2205A to require that Hedge and Market Loan Clearing Members, respectively, have adequate policies and procedures in place to perform a reconciliation of stock loan position balances between the records of the Clearing Member and any report or reports provided by OCC at least once per stock loan business day and resolve any discrepancies based on such report(s) for a given stock loan business day by 9:30 a.m. Central Time on the following stock loan business day. The proposed rule change would therefore ensure that OCC and its Clearing Members have an accurate and consistent understanding of each member's open stock loan positions at OCC and the obligations associated therewith.

2. Golden Copy Rules

OCC also proposes clarifying amendments to Articles XXI and XXIA of its By-Laws to emphasize that the records of OCC are the official record of open and closed stock loan transactions in the Stock Loan Programs and that Clearing Members remain liable for all obligations related to open stock loan positions as reflected in the records of OCC. In particular, OCC proposes to amend Article XXI, Sections 3 and 4 (relating to the agreements of Borrowing and Lending Clearing Members in the Hedge Program) and Article XXIA, Sections 3 and 4 (relating to the agreements of Borrowing and Lending Clearing Members in the Market Loan Program) to explicitly state that, in the event of a conflict between the records of OCC and any records generated by Borrowing or Lending Clearing Members regarding stock borrow or stock loan positions, the records generated by OCC will prevail and the Borrowing or Lending Clearing Member shall remain liable for all obligations associated with such stock borrow or stock loan positions maintained on the records of OCC. The proposed amendment would provide additional transparency and certainty to Clearing Members regarding OCC's treatment of its own records as the formal ''golden copy'' record of stock loan positions at OCC.

3. Termination Rules

OCC also proposes amendments to Rules 2209 and 2209A to provide that the termination of Hedge Loans and Market Loans, respectively, shall be deemed to be complete when the records of OCC reflect the termination of such stock loans. The proposed rule change is intended to clarify and reinforce that OCC's records of stock loan positions, and in particular, the termination of stock loan positions, are the formal record of cleared stock loan positions at OCC. OCC believes the proposed rule change will provide additional clarity and transparency around the obligations of OCC and its Clearing Members in the Stock Loan Programs, particularly where discrepancies may arise between the records of OCC and its Clearing Members concerning terminated stock loans.

4. Buy-In and Sell-Out Timeframe in Suspension

In order to mitigate the risks involved in the existing buy-in/sell-out process, as described in detail above, and enhance the resiliency of the Stock Loan Programs, OCC proposes to amend Rules 2211 and 2211A to require Lending Clearing Members or Borrowing Clearing Members that are instructed to buy-in or sell-out in connection with a Hedge or Market Loan Clearing Member suspension to execute such transactions by the close of the stock loan business day after the receipt of such instruction by OCC.[16] If the instructed Clearing Member fails to execute the buy-in or sell-out transaction within this timeframe, OCC would terminate the Stock Loan and effect Settlement based upon the Marking Price used at the close of business on the stock loan business day after the original instruction was made by OCC.

Additionally, OCC proposes a conforming change to Rules 2211 and 2211A to eliminate the requirement that Hedge or Market Loan Clearing Members executing a buy-in or sell-out must be prepared to defend the reasonableness of the timing of such transaction as all instructed Clearing Members would be required to execute the buy-in/sell-out within the newly specified two business day timeframe or be subject to automatic termination and settlement under the proposed rule change. OCC also proposes conforming changes to delete language stating that OCC, in its discretion and upon notice to the Lending Clearing Member or the independent broker, may fix a cash settlement value for the quantity of the Loaned Stock not returned to the Lending Clearing Member as this rule text would no longer be necessary under the proposed two-day buy-in/sell-out rules described above.

OCC believes the proposed changes will help to mitigate potential credit risks that may be associated with a delay in a Hedge or Market Loan Clearing Member effecting buy-in or sell-out transactions as it would ensure that positions are closed out—either through the buy-in/sell-out of stock loans by the instructed Hedge or Market Loan Clearing Members or by the automatic termination and settlement of stock loans by OCC—in a time period consistent with OCC's margin assumptions and thereby reducing the risk that the price paid or received for

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 positions.

[15] *See supra* note 4.

[16] In the situation of a buy-in, the Lending Clearing Member would be required to use the cash collateral to buy-in the securities. OCC would not be responsible for funding the buy-in.

the buy-in or sell-out of the Eligible Stock varies greatly from the price at which OCC last collected a Mark-to-Market Payment from the defaulter.

5. Authority To Enforce Reasonable Prices in the Buy-in/Sell-Out Process

Under existing Rules 2211 and 2211A, after a buy-in or sell-out occurs in a Clearing Member suspension scenario, OCC validates the prices reported by the Clearing Members to determine whether or not the price utilized to buy-in or sell-out is reasonable given the market prices during the two stock loan business day window. Clearing Members executing the buy-in or sell-out must be prepared to defend the reasonableness of the price, transactional costs, or cash settlement value of the transaction. OCC is proposing to amend Rules 2211 and 2211A to provide OCC with the authority to withdraw from the Clearing Member's account the value of any difference between the price reported by the Clearing Member executing the buy-in or sell-out, as applicable, and the price that OCC, in its sole discretion, determines to be reasonable. In addition, OCC proposes to amend Rules 2211 and 2211A to provide further clarity that a Clearing Member may defend the reasonableness of a reported price or cash settlement value of a buy-in or sell-out by demonstrating that it fell within the trading range of the Eligible Stock on that day. OCC believes this proposed change will further incentivize Clearing Members to execute a buy-in or sell-out at a reasonable price in accordance with the newly implemented two-day close out timeframe.

6. Hedge Program Re-Matching In Suspension

A significant portion of the activity in OCC's Hedge Program 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 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.

As discussed above, in the event of a Hedge Clearing Member suspension, OCC terminates the suspended Hedge Clearing Member's stock loans in accordance with the buy-in and sell-out process described in Rule 2211.[17] Due to the nature of Matched-Book Positions, OCC would be required to both recall the loan and return the borrowed shares to completely unwind the Matched-Book Positions. In addition to potential delays in the buy-in/sell-out process, this process also exposes OCC to potential price dislocation between the buy-in and sell-out transactions.

In addition, to the extent Borrowing and Lending Clearing Member counterparties to the suspended Hedge Clearing Member's Matched-Book Positions wish to maintain equivalent stock loan positions at OCC, those Borrowing and Lending Clearing 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 facilitate and settle those transactions, which introduce the potential for market disruption. 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, resulting in a temporary imbalance of the previously ''matched-book'' position. 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 transactions have been accepted, novated, and guaranteed by OCC.

OCC is proposing new Rule 2212 to allow OCC to perform an orderly close out of a suspended Hedge Clearing Member's Matched-Book Positions through the termination by offset and re-matching [18] of such positions, without requiring the transfer of securities against the payment of settlement prices as currently required under OCC Rule 2211. OCC believes the proposed rule change will strengthen the risk management processes in place at OCC by mitigating the risks involved in the buy-in/sell-out of Matched-Book Positions as well as provide the overall marketplace served by the Hedge Program with more stability.[19]

Proposed Rule 2212(a) would provide that, in the event that a suspended Hedge Clearing Member has Matched-Book Positions within the Hedge Program, OCC will, upon notice to affected Hedge Clearing Members, close out the suspended Hedge Clearing Member's Matched-Book Positions to the greatest extent possible by (i) the termination by offset of stock loan and stock borrow positions that are Matched-Book Positions in the suspended Hedge Clearing Member's account(s) and (ii) OCC's re-matching of stock borrow positions for the same number of shares in the same Eligible Stock maintained in a designated account of a Matched-Book Borrowing Clearing Member against a stock lending position for the same number of shares in the same Eligible Stock maintained in

[17] Rule 2211 also allows OCC, at its discretion, to instruct an independent broker, to buy in or sell out, as applicable, the Loaned Stock. In the case where the Lending Clearing Member or the independent broker fails to execute a buy-in or if, for any reason, effecting a buy-in is not permitted, OCC, in its discretion and upon notice to the Lending Clearing Member or the independent broker, may fix a cash settlement value for the quantity of the Loaned Stock not returned to the Lending Clearing Member. *See* OCC Rule 2211.

[18] In order to effect the re-matching of stock loan and borrow positions at OCC, OCC would simultaneously close out the existing positions of the Matched-Book Lending and Borrowing Clearing Members and create new stock loan and borrow positions between the re-matched members and OCC. As a result, the re-matched positions would maintain the benefits of OCC's guaranty throughout the re-matching process and would not require the re-matched Hedge Clearing Members to issue instructions to the Depository to terminate or initiate Stock Loans and transfer securities against the payment of Collateral.

[19] As further described in Item 5, OCC discussed the re-matching in suspension proposal with its Clearing Members at numerous member outreach forums and meetings. While members were generally supportive of the proposal, some members did raise concerns over the possibility of being re-matched with a counterparty with which the Clearing Member does not have an existing securities lending relationship. Specifically, Clearing Members noted that the proposal could result in a Hedge Clearing Member being re-matched with a counterparty with which it does not have an existing MSLA, which dictates all of the terms of the stock loan not governed by OCC's By-Laws and Rules (*e.g.,* Mark-to-Market percentage and rounding preferences), and could require operational changes in order to make deliveries to their new counterparty in the event of a termination or buy-in to close out the loan. OCC would mitigate these concerns by prioritizing the re-matching of Hedge Clearing Members that maintain between them current executed MSLAs, as discussed in more detail below. Moreover, even in light of these concerns, Clearing Members generally agreed that it is preferable to maintain a stock loan with another counterparty rather than attempting to close out stock loan positions in the event of a Hedge Clearing Member suspension as in many cases (and particularly in stressed market conditions) it could be difficult for the borrower to return the securities to the lender since the securities would likely be being used for other purposes.

a designated account of a Matched-Book Lending Clearing Member.

Under proposed Rule 2212(b), the Matched-Book Borrowing Clearing Member and Matched-Book Lending Clearing Member would not be required to issue instructions to the Depository in accordance with Rules 2202(a) and 2208(a) to terminate the relevant stock loan and stock borrow positions or to initiate new stock loan transactions to reestablish such positions, as the affected positions would be re-matched without requiring the transfer of securities against the payment of settlement prices.

Proposed Rule 2212(c) provides that OCC shall make reasonable efforts to re-match Matched-Book Borrowing Clearing Members with Matched-Book Lending Clearing Members that maintain between them current executed Master Securities Lending Agreements (''MSLAs''),[20] based on information provided by Hedge Clearing Members to the Corporation on an ongoing basis. In connection with the proposed rule change, OCC will add functionality to its ENCORE clearing system to allow Hedge Clearing Members to add and remove records of MSLA agreements between themselves and other Hedge Clearing Members. OCC would be entitled to rely on, and would have no responsibility to verify, the MSLA records provided by Hedge Clearing Members and on record as of the time of re-matching.

Under proposed Rule 2212(d), the termination by offset and re-matching of positions would be done using a matching algorithm in which the Matched-Book Positions of the suspended Hedge Clearing Member are first terminated by offset and then affected Matched-Book Borrowing Clearing Members and Matched-Book Lending Clearing Members are re-matched in order of priority based first upon whether the re-matched Clearing Members have an existing MSLA between them. Specifically, under the re-matching algorithm, OCC would first select the largest stock loan or stock borrow position in a given Eligible Stock from the suspended Hedge Clearing Member's Matched-Book Positions. The selected positions would then be re-matched with the largest available stock borrow or stock loan positions, as applicable, for the selected Eligible Stock for which a MSLA exists between a Matched-Book Borrowing Clearing Member and a Matched-Book Lending Clearing Member. OCC would repeat this process until all potential re-matching between Matched-Book Borrowing Clearing Members and Matched-Book Lending Clearing Members with MSLAs is completed. After re-matching among lenders and borrowers with existing MSLAs, the re-matching process would then be repeated for all remaining Matched-Book Positions for which MSLAs do not exist between the lenders and borrowers. During this stage, positions would be selected for re-matching in order of priority based on largest outstanding position size.

Under proposed Rule 2212(e), in the event Borrowing and Lending Clearing Members are re-matched through this process, the re-matched positions would be governed by the pre-defined terms and instructions established by the Lending Clearing Member pursuant to Rule 2201. In this case, the re-matched Hedge Clearing Members may choose to execute an MSLA or close-out the re-matched positions in accordance with existing Rule 2208. Any change in Collateral requirements arising from a change in the terms of stock loan or stock borrow positions between a Lending Clearing Member and Borrowing Clearing Member with re-matched positions would be included in the calculation of the Mark-to-Market Payment obligations as provided in Rule 2204 on the stock loan business day following the completion of the positions adjustments as set forth in proposed Rule 2212(f).

Under proposed Rule 2212(f), the termination by offset and re-matching of positions would be complete upon OCC completing all position adjustments in the accounts of the suspended Hedge Clearing Member and the Borrowing Clearing Members and Lending Clearing Members with re-matched positions and the applicable systems reports are produced and provided to the Clearing Members reflecting the transaction.

Under proposed Rules 2212(g)–(i), from and after the time OCC has completed the position adjustments as set forth in OCC Rule 2212(f), the suspended Hedge Clearing Member would have no further obligations under the By-Laws and Rules with respect to such positions; however, a Borrowing Clearing Member with re-matched stock borrow positions would remain obligated as a Borrowing Clearing Member and a Lending Clearing Member with re-matched stock loan positions would remain obligated as a Lending Clearing Member as specified in the By-Laws and Rules applicable to the Hedge Program. Moreover, upon notification that OCC has completed the termination by offset and re-matching of stock loan and borrow positions, the suspended Hedge Clearing Member and Borrowing Clearing Members and Lending Clearing Members with re-matched positions would be required to promptly make any necessary bookkeeping entries at the Depository necessitated by the re-matching to ensure the accuracy and efficacy of those stock loan terms not governed by OCC's By-Laws and Rules.

Finally, under proposed Rule 2212(j), Borrowing Clearing Members and Lending Clearing Members that have been re-matched would be required to work in good faith to either (i) reestablish any terms, representations, warranties and covenants not governed by the By-Laws and Rules (*e.g.,* establish an MSLA) or (ii) terminate the re-matched stock loan or borrow positions in the ordinary course pursuant to Rule 2208, as soon as reasonably practicable.

OCC also proposes a number of conforming changes to Article XXI, Sections 2–4 of the By-Laws and to Rule 2210 to reflect the proposed adoption of new Rule 2212. In particular, OCC would amend Rule 2210(b), which concerns the treatment of open stock loan and borrow positions resulting from Stock Loans of a suspended Hedge Clearing Member, to provide that such positions may now also be closed out using the re-match in suspension authority under proposed Rule 2212. Under the default management rules and procedures for stock loan positions in the Hedge Program, OCC would first attempt to close out any Matched-Book Positions of the suspended Hedge Clearing Member to the greatest extent possible using the re-match in suspension authority under proposed Rule 2212. After executing the re-matching process, OCC would generally look to close out the remaining stock loan positions of the suspended Clearing Member, to the extent that the defaulting member was the borrower of loans that were not matched, by using any stock pledged to OCC as margin collateral that is the same as the Eligible Stock in question to deliver to its counterparty lenders via the Depository. Finally, all remaining open stock loan positions would be closed out pursuant to the buy-in/sell-out process under Rule 2211, and in accordance with the proposed enhancements to that process as described herein.

2. Statutory Basis

Section 17A(b)(3)(F) of the Act,[21] requires, among other things, that the rules of a clearing agency be designed (i)

[20] Commission Staff received OCC's consent to insert ''Master Securities Lending Agreement'' before the acronym ''MSLA'' pursuant to a telephone conversation on March 6, 2017.

[21] 15 U.S.C. 78q–1(b)(3)(F).

to promote the prompt and accurate clearance and settlement of securities transactions; (ii) 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; (iii) in general, to protect investors and the public interest; and (iv) not to permit unfair discrimination among participants in the use of the clearing agency. Rule 17Ad–22(d)(11) [22] further requires registered clearing agencies to establish, implement, maintain and enforce written policies and procedures reasonably designed to make key aspects of the clearing agency's default procedures publicly available and establish default procedures that ensure that the clearing agency can take timely action to contain losses and liquidity pressures and to continue meeting its obligations in the event of a participant default.

In addition, recently adopted Rule 17Ad–22(e)(13) [23] requires covered clearing agencies to establish, implement, maintain and enforce written policies and procedures reasonably designed to, in part, ensure the covered clearing agency has the authority and operational capacity to take timely action to contain losses and liquidity demands and continue to meet its obligations in the event of a Clearing Member default. Moreover, recently adopted Rule 17Ad–22(e)(23) [24] requires covered clearing agencies to maintain written policies and procedures reasonably designed to, among other things, provide for publicly disclosing all relevant rules and material procedures, including key aspects of its default rules and procedures.

OCC believes that the proposed rule change is consistent with Section 17A(b)(3)(F) of the Act [25] and Rules 17Ad 22(d)(11), (e)(13), and (e)(23) [26] thereunder for the reasons set forth below.

Trade Balancing, Golden Copy, and Termination Rules

As described in detail above, OCC is proposing a number of improvements in the area of trade balancing and recordkeeping of stock loan positions at OCC. Specifically, the proposed rule change would require Clearing Members in the Stock Loan Programs to have adequate policies and procedures in place to perform reconciliations of open and closed stock loan and stock borrow positions to OCC's records at least once each stock loan business day and resolve any discrepancies based on such report(s) for a given stock loan business day by 9:30 a.m. Central Time on the following stock loan business day to minimize the risk inaccurate records may present. OCC is also proposing a number of clarifying amendments to its By-Laws and Rules to emphasize that the records of OCC are the official record of open and closed stock loan transactions in the Stock Loan Programs, including for terminations of stock loan positions, and that Clearing Members remain liable for all obligations related to open stock loan positions as reflected in the records of OCC.

The proposed rule change is designed to provide more certainty regarding the formal record of the open stock loan positions guaranteed by OCC and provide additional clarity and transparency around the obligations of OCC and its Clearing Members in the Stock Loan Programs, particularly where differences may arise between the records of OCC and its Clearing Members. OCC believes the proposed rule change would therefore reduce the likelihood of credit or operational risks arising due to discrepancies between the records of OCC and its Clearing Members. As a result, OCC believes the proposed rule change is designed to promote the prompt and accurate clearance and settlement of securities transactions and to assure the safeguarding of securities and funds in the custody or control of OCC or for which it is responsible in accordance with Section 17A(b)(3)(F) of the Act.[27]

Timeframe for Buy-In and Sell-Out in Suspension

OCC Rules 2211 and 2211A describe the buy-in and sell-out process in the event of a Hedge Clearing Member and Market Loan Clearing Member suspension, respectively, but the rules do not currently require that such actions be taken within a specified period of time. As described in detail above, OCC's margin and liquidation period assumptions contemplate a two-day close out process, which is applicable to all products without differentiation. Any delay in the buy-in/sell-out process could result in increased credit risk to OCC as the close out process for stock loans could fail to align with such margin and liquidation period assumptions. As a result, OCC may be exposed to credit risk if the price paid or received for the buy-in or sell-out of the Eligible Stock varies from the price at which OCC last collected a Mark-to-Market Payment from the defaulter and that price differential exceeds the amount of margin on deposit for such positions.

OCC proposes to amend Rules 2211 and 2211A to require Lending Clearing Members or Borrowing Clearing Members that are instructed to buy-in or sell-out in connection with a Hedge or Market Loan Clearing Member suspension to execute such transactions by the close of the stock loan business day after the receipt of such instruction by OCC.[28] If the instructed Clearing Member fails to execute the buy-in or sell-out transaction within this timeframe, OCC would terminate the Stock Loan and effect Settlement based upon the Marking Price used at the close of business on the stock loan business day after the original instruction was made by OCC.

OCC believes the proposed rule change will help to mitigate the potential credit risk that may be associated with a delay in a Hedge or Market Loan Clearing Member effecting buy-in or sell-out transactions by ensuring that positions are closed out—either through the buy-in/sell-out of stock loans by the Hedge Clearing Members or by the automatic termination and settlement of stock loans by OCC—in a time period consistent with OCC's margin assumptions. Accordingly, OCC believes the proposed rule change is designed to promote the prompt and accurate clearance and settlement of securities transactions, to assure the safeguarding of securities and funds which are 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.[29] Furthermore, the proposed rule change would make key aspects of OCC's default procedures for the Stock Loan Programs publicly available (particularly with respect to the buy-in/sell-out process) and would establish default procedures for the Stock Loan Programs that ensure that OCC can take timely action to contain losses and liquidity pressures and continue meeting its obligations in the event of a

[22] 17 CFR 240.17Ad–22(d)(11).

[23] 17 CFR 240.17Ad–22(e)(13). *See* Securities Exchange Act Release No. 78961 (September 28, 2016), 81 FR 70786 (October 13, 2016) (S7–03–14) (''Standards for Covered Clearing Agencies''). The Standards for Covered Clearing Agencies became effective on December 12, 2016. OCC is a ''covered clearing agency'' as defined in Rule 17Ad–22(a)(5) and therefore OCC must comply with new section (e) of Rule 17Ad–22 by April 11, 2017.

[24] 17 CFR 240.17Ad–22(e)(23).

[25] 15 U.S.C. 78q–1(b)(3)(F).

[26] 17 CFR 240.17Ad–22(d)(11), (e)(13), and (e)(23).

[27] 15 U.S.C. 78q–1(b)(3)(F).

[28] In the situation of a buy-in, the Lending Clearing Member would be required to use the cash collateral to buy-in the securities. OCC would not be responsible for funding the buy-in.

[29] 15 U.S.C. 78q–1(b)(3)(F).

participant default in accordance with Rules 17Ad–22(d)(11), (e)(13), and (e)(23).[30]

Authority To Enforce Reasonable Prices in Buy-In/Sell-Out Process

The proposed rule change would also provide OCC with the authority to withdraw from a Clearing Member's account the value of any difference between the price reported by the Clearing Member for a buy-in or sell-out under Rule 2211 and Rule 2211A, as applicable, and the price that OCC, in its sole discretion, determines to be reasonable (if OCC determines that the Clearing Member's reported price was unreasonable based on whether the reported price fell within the trading range of the Eligible Stock on that day). The proposed rule change is designed to incentivize Clearing Members to execute a buy-in or sell-out at a reasonable price in accordance with the newly implemented two-day close out timeframe, and would allow OCC to withdraw the difference for any buy-in or sell-out reported outside of the trading range of the Eligible Stock, thereby helping to ensure that the buy-in/sell-out is executed at a price that falls within OCC's margin and liquidation assumptions. As a result, OCC believes the proposed rule change is 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 OCC or for which it is responsible, in accordance with Section 17A(b)(3)(F) of the Act.[31] Moreover, OCC believes the proposed change would make key aspects of OCC's default procedures for the Stock Loan Program publicly available (particularly with respect to the buy-in/sell-out process) and would establish default procedures for the Stock Loan Programs that ensure that OCC can take timely action to contain losses and liquidity pressures and continue meeting its obligations in the event of a participant default in accordance with Rules 17Ad–22(d)(11), (e)(13), and (e)(23).[32]

Re-Matching In Suspension

As noted above, a significant portion of the activity in OCC's Hedge Program relates to matched-book activity. Under OCC's existing rules, OCC would terminate a suspended Hedge Clearing Member's Matched-Book Positions in accordance with the buy-in and sell-out process contained in Rule 2211. Logistically, this requires OCC to both recall the loan and return the borrowed shares to completely unwind the Matched-Book positions, which exposes OCC to potential price dislocation between the buy-in and sell-out transactions. Moreover, as noted above, the buy-in/sell-out process effectively utilizes each counterparty to the suspended Hedge Clearing Member's Matched-Book Positions as independent ''liquidating agents,'' making the process prone to greater operational and execution risk due to the number of counterparties effecting the buy-in/sell-out transactions, and thereby posing risks to the prompt and accurate clearance and settlement of securities transactions and the safeguarding of securities and funds associated therewith. In addition, to the extent Borrowing and Lending Clearing Member counterparties to the Matched-Book Positions wish to maintain equivalent stock loan positions at OCC, those Clearing Members would be required to initiate new stock loans to replace the closed out positions and would 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.

Proposed Rule 2212 would allow OCC to perform an orderly close out of a suspended Hedge Clearing Member's 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 Rule 2211. As a result, the proposed rule change would minimize the potential for operational and execution risks and eliminate any risk resulting from potential price dislocation between recall and return transactions. OCC believes the proposed rule change will strengthen the risk management processes in place at OCC by mitigating the risks involved in the buy-in/sell-out of Matched-Book Positions as well as provide the overall marketplace with more stability with respect to the Hedge Program. OCC therefore believes the proposed rule change is designed to promote the prompt and accurate clearance and 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.[33]

In addition, OCC would use a matching algorithm to re-match stock loan and stock borrow positions in order of priority based on the largest available stock borrow or stock loan positions, as applicable, for the selected Eligible Stock for which a MSLA exists between the Borrowing and Lending Clearing Members. In the event Hedge Clearing Members are re-matched that do not have existing securities lending relationships, those members may choose to either work in good faith to reestablish any terms, representations, warranties and covenants not governed by the By-Laws and Rules (*e.g.,* MSLA) or to terminate the re-matched stock loan or borrow positions in the ordinary course pursuant to Rule 2208, as soon as reasonably practicable. The proposed rule change therefore provides for an objective process for re-matching stock loan and borrow positions and ensures that members with existing securities lending relationships are re-matched to the greatest extent possible and would still allow for Hedge Clearing Members that are re-matched but that do not have existing securities lending relationships to terminate such positions in the ordinary course pursuant to Rule 2208. As a result, OCC believes that the proposed rule change is designed not to permit unfair discrimination among participants in the use of the clearing agency in accordance with Section 17A(b)(3)(F) of the Act.[34]

Furthermore, OCC believes the proposed rule change would make key aspects of OCC's default procedures for the Hedge Program publicly available (particularly with respect to the close out of Matched-Book Positions) and would establish default procedures for the Hedge Program that ensure that OCC can take timely action to contain losses and liquidity pressures and continue meeting its obligations in the event of a participant default in accordance with Rules 17Ad–22(d)(11), (e)(13), and (e)(23).[35]

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

Section 17A(b)(3)(I) of the Act[36] requires that the rules of a clearing agency not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. OCC does not believe that the proposed rule change would have any impact or impose any burden on competition. The proposed rules are generally designed to: (1)

[30] 17 CFR 240.17Ad–22(d)(11), (e)(13), and (e)(23).

[31] 15 U.S.C. 78q–1(b)(3)(F).

[32] 17 CFR 240.17Ad–22(d)(11), (e)(13), and (e)(23).

[33] 15 U.S.C. 78q–1(b)(3)(F).

[34] *Id.*

[35] 17 CFR 240.17Ad–22(d)(11), (e)(13), and (e)(23).

[36] 15 U.S.C. 78q–1(b)(3)(I).

Require Clearing Members to have robust processes in place to reconcile open interest in the Stock Loan Programs at least once per stock loan business day; (2) further clarify that stock loan positions at OCC are not terminated until the records of OCC reflect the termination of such stock loan; (3) provide further clarity and certainty around the formal records for stock loan positions being guaranteed by OCC at any given time; (4) provide a specific timeframe in which Clearing Members in the Stock Loan Programs must buy-in or sell-out of stock loan positions in the event of another Hedge or Market Loan Clearing Member suspension, as applicable; (5) provide OCC with the authority to withdraw from a Clearing Member's account the value of any difference between the price reported by a Clearing Member instructed to execute a buy-in or sell-out of loaned stock as a result of another Clearing Member suspension, and the price that OCC determines to be reasonable; and (6) allow OCC to close out the Matched-Book Positions of suspended Hedge Clearing Members 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 rules would be equally applicable to all Clearing Members in OCC's Stock Loan Programs and are intended to strengthen the risk management processes in place at OCC and provide the overall marketplace with more stability with respect to the Hedge Program in the event of a Hedge Clearing Member suspension. Accordingly, OCC does not believe that the proposed rule change would have any impact or impose a burden on competition.

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

Written comments were not and are not intended to be solicited with respect to the proposed rule change and none have been received. OCC has, however, discussed the re-matching in suspension proposal with its Clearing Members at numerous member outreach forums and meetings. While members were generally supportive of the proposal, some members did raise concerns over the possibility of being re-matched with a counterparty with which the Clearing Member does not have an existing securities lending relationship. For example, some Clearing Members noted that they could be re-matched with counterparties with which they do not have an existing MSLA, which dictates all of the terms of the stock loan not governed by OCC's By-Laws and Rules (*e.g.,* Mark-to-Market percentage and rounding preferences). In addition, re-matched counterparties that do not have an existing securities lending relationship would need to make operational changes in order to make deliveries to their new counterparty in the event of a termination or buy-in to close out the loan.

OCC carefully considered this member feedback in the development of its proposal, and in order to mitigate these concerns, the proposed re-matching in suspension rules would require OCC to make reasonable efforts to re-match Hedge Clearing Members that maintain between them current executed MSLAs. Specifically, under the proposed rule change, OCC would use a matching algorithm to re-match stock loan and stock borrow positions in order of priority based on the largest available stock borrow or stock loan positions, as applicable, for the selected Eligible Stock for which a MSLA exists between the Borrowing and Lending Clearing Members to ensure that members with existing securities lending relationships are re-matched to the greatest extent possible. Even in light of these concerns, however, Clearing Members generally agreed that it is preferable to maintain a stock loan with another counterparty rather than attempting to close out stock loan positions in the event of a Hedge Clearing Member suspension as in many cases (and particularly in stressed market conditions) it could be difficult for the borrower to return the securities to the lender since the securities would likely be being used for other purposes.

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

Within 45 days of the date of publication of this notice in the **Federal Register** or within such longer period up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self- regulatory organization consents, the Commission will:

(A) By order approve or disapprove the proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

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:

Electronic Comments

- Use the Commission's Internet comment form (*http://www.sec.gov/rules/sro.shtml*); or
- Send an email to *rule-comments@sec.gov.* Please include File Number SR–OCC–2017–004 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–2017–004. This file number should be included on the subject line if email 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 Web site (*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 Web site 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 Web site at *http://www.theocc.com/components/docs/legal/rules_and_bylaws/sr_occ_17_004.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–2017–004 and should be submitted on or before April 4, 2017.

For the Commission, by the Division of Trading and Markets, pursuant to delegated Authority.[37]

Eduardo A. Aleman,

Assistant Secretary.

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[37] 17 CFR 200.30–3(a)(12).