SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–50526; File No. SR–OCC–2004–13]

Self-Regulatory Organizations; The Options Clearing Corporation; Order Granting Approval of a Proposed Rule Change Relating to Borrowing Against the Clearing Fund

October 13, 2004.

I. Introduction

On June 23, 2004, The Options Clearing Corporation (''OCC'') filed with the Securities and Exchange Commission (''Commission'') proposed rule change SR–OCC–2004–13 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'').[1] Notice of the proposal was published in the **Federal Register** on September 7, 2004.[2] No comment letters were received. For the reasons discussed below, the Commission is granting approval of the proposed rule change.

II. Description

The proposed rule change amends Article VIII of OCC's By-Laws, which authorizes OCC to borrow against the clearing fund in specified situations. Section 5(e) of Article VIII of OCC's By-Laws authorizes OCC to take possession of and pledge as security for a loan cash and securities in its clearing fund under the following circumstances:

(1) If a clearing member is suspended and OCC is unable to obtain prompt delivery of or convert promptly to cash any asset credited to any of the clearing member's accounts and as a result OCC deems it necessary or advisable to borrow funds to meet obligations arising out of the suspension or

(2) If OCC sustains a loss due to the failure of a bank or another clearing organization, and elects to borrow funds in lieu of immediately charging the loss to the clearing fund.

In either case, OCC must first determine that it cannot borrow the necessary funds on an unsecured basis and must use the proceeds from the borrowing solely for the purposes above. Such use of clearing fund assets are limited to a maximum of 30 days. After 30 days, the amount of the loan must be charged against the clearing fund.

In the event of a clearing member default, OCC may need immediate liquidity even before it has made the decision to suspend the clearing member. Historically, defaults tend to occur at 9 a.m. (CT) when clearing members' accounts are debited for options premiums, exercise settlement payments, and mark-to-market payments.[3] Although OCC may be able to make settlement by using its own cash or by borrowing against its unsecured credit lines, which are currently $20 million, it is possible that those resources would not be sufficient.

Under the current By-Laws provisions in order to borrow against its secured lines of credit, which are currently $150 million and are in the process of being doubled, using a defaulting member's clearing fund contributions or collateral, OCC would have to (i) suspend the clearing member and (ii) have difficulty in obtaining or liquidating the defaulting clearing member's collateral. If a default is not quickly remedied, OCC will likely suspend the defaulting clearing member. However, OCC believes that it should not have to make the decision to suspend as a precondition to borrowing against the clearing fund. Similarly, OCC believes that it should not be a precondition to such use of the clearing fund that OCC is unable to obtain ''prompt'' delivery of or convert ''promptly'' to cash any asset credited to an account of a defaulting clearing member. OCC interprets ''prompt'' and ''promptly'' in this context as meaning ''in sufficient time to enable OCC to use the proceeds to meet its obligations.'' However, OCC does not believe that its ability to such use of the clearing fund should turn on questions of interpretation.

Accordingly, OCC is amending Article VIII, Section 5(e) of its By-Laws to eliminate the requirements that OCC (i) suspend a defaulting clearing member and (ii) be unable to obtain prompt delivery of collateral or be unable to convert it promptly to cash as preconditions to use of the clearing fund. As amended, Section 5(e) will allow OCC to use clearing fund assets as collateral for loans whenever OCC deems such borrowings to be necessary or advisable in order to meet obligations arising out of the default or suspension of a clearing member or any action taken by OCC in connection therewith.

OCC believes that the proposed rule change is consistent with Section 17A of the Act and the regulations thereunder because it enhances OCC's ability to respond to and manage clearing member defaults in a manner that increases the protection of investors and persons facilitating transactions by and acting on behalf of investors and because it limits systematic risk.

III. Discussion

Section 17A(b)(3)(F) of the Act requires, among other things, that the rules of a clearing agency be designed to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible.[4] OCC's By-Laws currently provide that OCC may borrow against the clearing fund to meet its obligations in the event a clearing member is suspended and OCC cannot promptly access the clearing member's assets. The proposed rule change modifies OCC's By-Laws by allowing OCC to borrow against the clearing fund if a clearing member defaults on its obligations without having to suspend the clearing member and determine that it cannot obtain or liquidate the member's assets. The proposed rule change should allow OCC to more readily have the liquidity it may need in the event of a clearing member default and does not otherwise affect the rights and obligations of OCC or its members regarding the clearing fund. Accordingly, because the proposed rule change is designed to help assure that OCC will be able to meet its settlement obligations and does not jeopardize the integrity of OCC's clearing fund, it is designed to assure the safeguarding of securities and funds which are in the custody or control of OCC or for which OCC is responsible.

IV. Conclusion

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

It is therefore ordered, pursuant to section 19(b)(2) of the Act, that the proposed rule change (File No. SR–OCC–2004–13) be and hereby is approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.[5]

Margaret H. McFarland,

Deputy Secretary.

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

[2] Securities Exchange Act Release No. 50280, (August 27, 2004), 69 FR 54172.

[3] This is also the time when members' accounts are debited for margin deficiencies, but margin payments, unlike premium, exercise settlement, and mark-to-market payments, are not pass-through payments.

[4] 15 U.S.C. 78q–1(b)(3)(F).

[5] 17 CFR 200.30–3(a)(12).