

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-58988; File Nos. SR-OCC-2008-18 and SR-NSCC-2008-09)

November 20, 2008

Self-Regulatory Organizations; The Options Clearing Corporation and National Securities Clearing Corporation; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Changes Relating to Amendment No. 2 to the Third Amended and Restated Options Exercise Settlement Agreement

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> notice is hereby given that on November 17, 2008, The Options Clearing Corporation (“OCC”) and the National Securities Clearing Corporation (“NSCC”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule changes described in Items I and II, and III below, which items have been prepared primarily by OCC and NSCC. The Commission is publishing this notice and order to solicit comments from interested persons and to grant approval of the proposals.

I. Self-Regulatory Organizations’ Statements of the Terms of Substance of the Proposed Rule Changes

The proposed rule changes would amend the Third Amended and Restated Options Exercise Settlement Agreement between OCC and NSCC as described herein.

II. Self-Regulatory Organizations’ Statements of the Purpose of, and Statutory Basis for, the Proposed Rule Changes

In their filings with the Commission, OCC and NSCC included statements concerning the purpose of and basis for the proposed rule changes and discussed any comments they received on the proposed rule changes. The text of these statements may be examined at the places specified in

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

Item IV below. OCC and NSCC have prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of these statements.<sup>2</sup>

(A) Self-Regulatory Organizations' Statements of the Purpose of, and Statutory Basis for the Proposed Rule Changes

The purpose of the proposed rule changes is to reduce the burden on clearing members of OCC that are also members of NSCC that results from duplicative margin requirements relating to option exercises and assignments and to allow clearing members to use stock deposited as margin with OCC to meet settlement obligations at NSCC.

OCC and NSCC are parties to a Third Amended and Restated Options Exercise Settlement Agreement dated as of February 16, 1995, as amended ("OCC/NSCC Accord"), which provides for a two-way guaranty between OCC and NSCC of the mark-to-market amounts for which NSCC has guaranteed settlement. Through these rule changes, OCC and NSCC seek approval for an Amendment No. 2 to the OCC/NSCC Accord ("Amendment") that would address the matters stated above.

Under the OCC/NSCC Accord currently in effect, OCC guarantees to NSCC the performance by NSCC members of settlement obligations resulting from exercise and assignment ("E&A") positions, with the amount guaranteed by OCC with respect to the performance of an NSCC member's settlement obligation equal to the smaller of the "Net Member Debit to NSCC" and the "Calculated Margin Requirement" with respect to the NSCC member. OCC can make this guarantee because it continues to margin E&A activity through the settlement date.<sup>3</sup> Similarly, NSCC guarantees to OCC the smaller of the "Net Member Debit to

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<sup>2</sup> The Commission has modified the text of the summaries prepared by OCC and NSCC.

<sup>3</sup> In the case of E&A activity resulting from exercises at expiration ("Expiration E&A Activity"), the settlement date is normally the Wednesday after expiration.

OCC” and the “Calculated Margin Credit.” NSCC can make this guarantee because it collects risk-based margin on the member’s entire portfolio of E&A activity.<sup>4</sup>

Both OCC and NSCC collect margin with respect to E&A positions through settlement, calculated utilizing risk-based margining methodologies which include volatility charges. OCC collects risk margin to cover (i) the risk that NSCC might decline to settle a defaulting member’s pending E&A activity<sup>5</sup> thereby forcing OCC to guarantee buy-ins and sell-outs and (ii) the risk that the market might move against E&A positions accepted by NSCC for settlement thereby increasing OCC’s potential liability to NSCC under the OCC/NSCC Accord. NSCC collects a volatility charge because OCC’s liability under the OCC/NSCC Accord is limited to the negative mark-to-market value of E&A positions as of the close on the day before the member was suspended. To a considerable degree, NSCC’s VAR margin and OCC’s risk margin overlap, covering the same risk.

This dual obligation to OCC and NSCC with respect to E&A positions may constitute a significant temporary financial burden on NSCC members and OCC clearing members, particularly during the three business days following options expiration each calendar month. This burden has significantly grown as recent market conditions have caused an increase in the volatility charges of both clearing corporations. The Amendment addresses this problem in two ways. First, it accelerates NSCC’s guarantee of Expiration E&A Activity to the time on T+1 when the member meets its morning NSCC clearing fund requirement instead of midnight.

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<sup>4</sup> Because OCC marks E&A activity to the market and guarantees that amount to NSCC, NSCC does not mark E&A positions to the market. However, it does collect VAR margin to cover potential losses in liquidating E&A positions.

<sup>5</sup> Under its rules, NSCC’s guaranty does not attach until midnight on T+1. For exercises on expiration weekend, T+1 is normally the following Monday.

Second, it provides that in calculating OCC's obligations to NSCC, Expiration E&A Activity would be marked to the previous day's close only: (i) on T+1 (because even if the member failed to settle with OCC on T+1, OCC would be holding risk margin collected on T to cover that risk) and (ii) on T+2 and T+3 if, and only if, OCC had collected that morning's mark-to-market payment. If the member failed before OCC collected that morning's mark, pending Expiration E&A Activity would be marked to the second previous day's close.<sup>6</sup>

The combined effect of these two changes is to enable OCC to stop collecting risk margin on Expiration E&A Activity after the morning of T+1. Once the member meets its morning clearing fund requirement at NSCC on T+1, NSCC would be responsible for settling those positions, and OCC could not be liable to NSCC under the Accord for more than the mark-to-market that OCC had already collected so there would be no risk to be margined. NSCC's risk in this regard would be covered by its collection of margin.

OCC estimates that if this arrangement had been in place during recent months, it would have reduced daily margins for OCC clearing members during the week after expiration by \$2 billion in August (affecting 89 members), \$3.7 billion in September (93 members), and \$3 billion in October (95 members). The Amendment is intended to mitigate burdens on NSCC and OCC members while retaining adequate margin to protect both OCC and NSCC.

In order to further mitigate financial burden and facilitate the settlement, on any exercise settlement date, of the settlement obligations relating to assigned short positions, OCC and NSCC, together with DTC, have established a program to permit an NSCC member that has a security deliver obligation on an exercise settlement date with respect to an assigned short

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<sup>6</sup> See the example at the end of Section 3 of the Amendment. Copies of the Amendment are attached as Exhibit 5 to the proposed rule changes and is available at [http://www.theocc.com/publications/rules/proposed\\_changes/sr\\_occ\\_08\\_18.pdf](http://www.theocc.com/publications/rules/proposed_changes/sr_occ_08_18.pdf) and [http://www.dtcc.com/downloads/legal/rule\\_filings/2008/nscc/2008-09.pdf](http://www.dtcc.com/downloads/legal/rule_filings/2008/nscc/2008-09.pdf).

position to request OCC to release underlying securities pledged to OCC at DTC by the NSCC member to meet the NSCC member's OCC margin or cover requirement so that the NSCC member may fully or partially complete its continuous net settlement security deliver obligation at NSCC on such exercise settlement date. Some OCC members use stock held at DTC and pledged to OCC as a "specific deposit" to cover short positions. However, if the short position is assigned, the member has to obtain other stock to deliver to NSCC. OCC will release the specific deposit once the member settles with NSCC, but obtaining stock to deliver to NSCC can strain the member's liquidity. Until recently, clearing members expressed little or no interest in using systems designed to allow members to use deposited stock to meet settlement obligations at NSCC if covered positions were assigned. However, clearing members have expressed increased interest given current demands on member liquidity. For OCC to be able to activate these systems, the Amendment will exclude positions settled by the delivery of specific deposits from the calculation of OCC's guarantee exposure. OCC also needs to perform some minor coding and testing. In order to avoid the need for a separate amendment when that work is completed, the necessary amendment is included in Section 4 of the Amendment.<sup>7</sup> Section 4 will become effective when NSCC and OCC jointly announce that the systems are ready for use.

The Amendment recites that it will be in effect until November 1, 2009 unless further extended by mutual agreement. The reason for this "sunset" provision is that OCC and NSCC intend to restate the OCC/NSCC Accord in its entirety in order to address and clarify various issues.

OCC and NSCC believe that the proposed rule changes are consistent with the purposes and requirements of Section 17A of the Act because it is designed to promote the prompt and

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<sup>7</sup> Supra, note 6.

accurate clearance and settlement of options exercises and assignments, to remove impediments to and perfect the mechanism of a national system for the prompt and accurate clearance and settlement of such transactions, and, in general, to protect investors and the public interest. It accomplishes this purpose by eliminating duplicative margin requirements and providing more efficient stock settlement procedures where stock required to be delivered to NSCC is pledged to OCC.

(B) Self-Regulatory Organizations' Statements on Burden on Competition

OCC and NSCC do not believe that the proposed rule changes would impose any burden on competition.

(C) Self-Regulatory Organizations' Statements on Comments on the Proposed Rule Changes Received from Members, Participants, or Others

Written comments relating to the proposed rule changes have not been solicited or received.

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

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 and to foster cooperation and coordination with persons engaged in the clearance and settlement of securities transactions.<sup>8</sup>

While the Amendment should reduce duplicative margin holdings and enable increased efficiency in stock settlement procedures where stock required to be delivered to NSCC is pledged as margin collateral with OCC the Commission believes that the proposals have been designed in such a manner that they are consistent with OCC's and NSCC's obligations to assure the safeguarding of securities and funds in the custody or control of the clearing agency or for

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<sup>8</sup> 15 U.S.C. 78q-1(b)(3)(F).

which they are responsible. Additionally, the proposed rule changes should foster cooperation and coordination between OCC and NSCC.

OCC and NSCC have requested that the Commission approve the proposed rules prior to the thirtieth day after publication of the notice of filing. The Commission finds good cause for approving the proposed rule changes prior to the thirtieth day after publication of notice because such approval will permit OCC and NSCC to implement the proposed rule changes prior to the November options expiration on November 22, 2008.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule changes are 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 e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Numbers SR-OCC-2008-18 and SR-NSCC-2008-09 on the subject line.

##### Paper comments:

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

All submissions should refer to File Numbers SR-OCC-2008-18 and SR-NSCC-2008-09. These file numbers should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The

Commission will post all comments on the Commission's Internet 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 changes that are filed with the Commission, and all written communications relating to the proposed rule changes 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 inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. Copies of such filings also will be available for inspection and copying at the principal offices of OCC and NSCC and on OCC's and NSCC's Web sites at [http://www.theocc.com/publications/rules/proposed\\_changes/sr\\_occ\\_08\\_18.pdf](http://www.theocc.com/publications/rules/proposed_changes/sr_occ_08_18.pdf) and [http://www.dtcc.com/downloads/legal/rule\\_filings/2008/nscc/2008-09.pdf](http://www.dtcc.com/downloads/legal/rule_filings/2008/nscc/2008-09.pdf), respectively. 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 Numbers SR-OCC-2008-18 and SR-NSCC-2008-09 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

#### IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule changes are consistent with the requirements of the Act and in particular Section 17A of the Act and the rules and regulations thereunder.<sup>9</sup>

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<sup>9</sup> In approving the proposed rule changes, the Commission considered the proposals' impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule changes (File No. SR-OCC-2008-18 and SR-NSCC-2008-09) be and hereby are approved on an accelerated basis.

For the Commission by the Division of Trading and Markets, pursuant to delegated authority.<sup>10</sup>

Florence E. Harmon  
Acting Secretary

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<sup>10</sup> 17 CFR 200.30-3(a)(12).