

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-73143; File No. SR-OCC-2014-16)

September 18, 2014

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of Amendment No. 1, and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 1, to Apply Enhanced Post-Trade Price Reasonableness Checks on Confirmed Trades in Standardized Options and Futures Options to Increase the Likelihood that Erroneous Trades will be Identified and Voided

On July 21, 2014, The Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change SR-OCC-2014-16 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder.<sup>2</sup> The proposed rule change was published for comment in the Federal Register on August 5, 2014.<sup>3</sup> The Commission received one comment on the proposal.<sup>4</sup> On August 20, 2014, OCC filed Amendment No. 1 to the proposal.<sup>5</sup> The Commission is publishing this notice to solicit comments on Amendment

---

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

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Securities Exchange Act Release No. 32718 (July 30, 2014), 79 FR 45527 (August 5, 2014) (SR-OCC-2014-16) (“Notice”).

<sup>4</sup> See Letter to Elizabeth M. Murphy, Secretary, Commission, from Ellen Greene, Vice President, Securities Industry and Financial Markets Association, dated August 21, 2014. The commenter strongly agreed with OCC’s proposal and believed that it is appropriate that the Commission approve the proposal. OCC did not respond to the comment.

<sup>5</sup> In Amendment No. 1, OCC amended the proposal to further clarify the criteria OCC will use to identify trades for referral to exchanges for evaluation under the obvious error or other applicable exchange rules. Specifically, OCC clarified that it would include a “5% intrinsic value threshold,” as described more fully below, to identify trades for referral to exchanges. OCC stated that it would review this threshold on a quarterly basis for continued adequacy and any adjustments to the threshold will be the subject of rule filing with the Commission.

No. 1 and is approving the proposed rule change, as modified by Amendment No. 1, on an accelerated basis.

I. Description of the Proposal

OCC proposed to add an interpretation and policy concerning its administration of existing Article VI, Section 7(c) of the By-Laws and to implement price reasonableness checks in connection with the reporting of confirmed trades in standardized options and futures options to OCC by an exchange under Article VI, Section 7 and Rule 401. Article VI, Section 7(c) provides that an exchange may instruct OCC to disregard a confirmed trade previously reported to OCC for clearance and settlement under certain circumstances.<sup>6</sup> One such circumstance is a determination that “new or revised trade information was required to properly clear the transaction.” To promote OCC’s ability to protect itself and clearing members from the negative effects of clearing trades in standardized options and futures options that may contain erroneous premium information, OCC would apply to accepted trades a premium price threshold triggering further scrutiny of trades that exceed it.

*Background*

According to OCC, the Board of Directors and Risk Committee have been evaluating risk controls with respect to trades priced significantly away from current

---

<sup>6</sup> See Article VI, Section 7(c); see also Exchange Act Release No. 46734 (October 28, 2002), 67 FR 67229 (November 4, 2002) (SR-OCC-2002-18) (approving amendments to OCC’s By-Laws and Rules supporting the transition to near real-time reporting of matched trade information, including amendments to Article VI, Section 7 to allow instructions to OCC under certain conditions to disregard a matched trade).

market prices and the risks they present to OCC.<sup>7</sup> OCC stated that it anticipates the proposed price reasonableness review process would be put in place while it also develops other post-trade risk controls for potential implementation.

*Post-Trade Price Validation Process*

According to OCC, earlier this year, a trade data entry parameter in OCC's systems that does not allow OCC to accept a trade having a premium price of more than \$9,999.99 per contract prevented OCC from accepting erroneous trades that resulted from a trading algorithm error of a customer of a clearing member. If the systems parameter had not prevented OCC from accepting the trades, the settlement obligation for the clearing member for these trades alone could have exceeded \$800 million. This amount would have been in addition to any other settlement obligation of the clearing member.

In light of the incident, and to promote the protection of OCC and clearing members from erroneous trades, OCC's Risk Committee directed OCC to perform an analysis of whether OCC should implement procedures regarding a reasonableness review for premium prices at some threshold level less than the current systems parameter of \$9,999.99 per contract. Based on its internal analysis, OCC determined that it is appropriate to set a premium price limit of \$2,000 per contract because that premium threshold protects OCC and clearing members from erroneous trades that have the potential to cause significant settlement obligations while simultaneously not applying

---

<sup>7</sup> See e.g., OCC Press Release, OCC and The U.S. Options Exchanges Adopt New Pre- and Post-Trade Risk Control Principles (May 21, 2014), [http://www.theocc.com/about/press/releases/2014/05\\_21.jsp](http://www.theocc.com/about/press/releases/2014/05_21.jsp). OCC stated that it intends that these principles will be the subject of additional proposed rule changes.

the post-trade price reasonableness check review to a material number of trades that may be valid.

Under the proposed process, receipt of a trade that exceeds the premium price limit of \$2,000 per contract will generate an automatic notice to alert OCC staff.<sup>8</sup> After being accepted into OCC's systems for clearing, certain trades will be referred by OCC to the reporting exchange for evaluation under the obvious error or other applicable rules of the exchange. To identify trades for referral, OCC staff will compare the trade price to the approximate intrinsic value of the option. (Intrinsic value reflects the amount, if any, by which the option is in the money.) If the difference between such values exceeds five percent (5%), the trade will be referred. OCC believes that applying this preliminary reasonableness check will enhance the effectiveness of its proposed review process by reducing the likelihood that valid trades are referred to the reporting exchange. OCC estimates the trade identification and referral process should take less than an hour from initiation by OCC to full resolution by a reporting exchange. While a trade is involved in the post-trade reasonableness check process, OCC will not report the position to clearing members or further process the trade. In the event the exchange determines that the trade is valid, the exchange will notify OCC and the trade will continue through OCC's clearing and reporting processes using the originally reported price. If the exchange determines that the trade was in error or erroneously priced such that, as provided in Article VI, Section 7(c), new or revised trade information is required to properly clear the transaction, OCC expects the exchange will instruct OCC to disregard or "bust" the trade. However, in the event the exchange does not exercise its authority under its own rules to

---

<sup>8</sup> OCC also intends to retain its current system parameter of \$9,999.99 per contract as well.

instruct OCC to disregard the trade pursuant to Article VI, Section 7(c), the trade will continue through OCC's clearing and reporting process using the originally reported price.

OCC will provide notice to market participants of the post-trade price reasonableness check process, and the process will be implemented upon regulatory approval. OCC believes this implementation timing is appropriate because OCC's Board instructed OCC to implement the post-trade risk control as quickly as practicable. OCC's decision to implement the process for price reasonableness checks and to set the premium price limit at the \$2,000 level also necessitates related systems changes and conforming changes to certain policies and procedures. Conforming changes to affected policies and procedures include amending OCC's trade and position processing policy. Certain policies and procedures will also be updated to reflect aspects of the process for price reasonableness checks related to governance processes at OCC that are described in more detail below.

#### *Ongoing Oversight of the Proposed Post-Trade Price Validation Process*

The premium level at which the price reasonableness review process is triggered will be subject to adjustment or suspension under certain conditions. OCC states that it will review the level on a quarterly basis for continued adequacy.<sup>9</sup> In the event the maximum premium price traded over the prior quarter declines by a predetermined dollar amount or the average number of valid trades referred to reporting exchanges exceeds a predetermined number of occurrences per quarter, OCC will be authorized to adjust the

---

<sup>9</sup> OCC states that it will also review the 5% intrinsic value threshold on a quarterly basis for continued adequacy. Any changes to this threshold will be the subject of a subsequent rule filing with the Commission.

applicable premium level.<sup>10</sup> Establishment of such level and any modification thereof that may be made from time to time must be reported to the Risk Committee. In addition, the Executive Chairman, President or Chief Operating Officer will be authorized to temporarily summarily suspend the then-applicable premium limit in the event that in excess of a predetermined number of valid trades are being referred to the reporting exchanges for review provided, however, that when the causes responsible for the temporary suspension are resolved, the approved premium threshold will be reinstated. The Risk Committee, along with the Chief Risk and Compliance Officers, will be advised of any such suspension. OCC believes these processes help ensure an appropriate level of management and Risk Committee oversight for the continued effectiveness of the proposed price reasonableness review process.

## II. Discussion and Commission Findings

Section 19(b)(2)(C) of the Act<sup>11</sup> directs the Commission to approve a proposed rule change of a self-regulatory organization if it finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to such organization.

The Commission finds that the proposed rule change is consistent with Section 17A(b)(3)(F) of the Act,<sup>12</sup> and Rule 17Ad-22(d)(4) of the Act.<sup>13</sup> Section 17A(b)(3)(F) of

---

<sup>10</sup> Any such action by OCC regarding the premium level would also be subject to the regulatory process of filing a proposed rule change with the Commission.

<sup>11</sup> 15 U.S.C. 78s(b)(2)(C).

<sup>12</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>13</sup> 17 CFR 240.17Ad-22(d)(4).

the Act<sup>14</sup> requires, in part, that the rules of a registered clearing agency be 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 the clearing agency for which it responsible, to foster cooperation and coordination with persons engaged in the clearance and settlement of securities transactions, and to protect investors and the public interest. OCC's proposed rule is consistent with these requirements because it is designed to increase the likelihood that erroneous trades in standardized options and futures options will be identified and voided by reporting options exchanges by OCC identifying and referring to the exchanges certain confirmed trades in standardized options and futures options for which new or revised trade information may be required to properly clear the transaction.

In so doing, OCC's proposal is designed to protect investors from the costs of erroneous trades that have the potential to cause significant settlement obligations while, at the same time, balancing the need to protect investors from the likelihood that valid trades will be referred back to the exchanges.

Rule 17Ad-22(d)(4) of the Act<sup>15</sup> requires, in part, for registered clearing agencies to establish, implement, maintain and enforce written policies and procedures reasonably designed to identify sources of operational risk and minimize them through the development of appropriate systems, controls, and procedures. OCC's proposed rule is consistent with Rule 17Ad-22(d)(4) of the Act<sup>16</sup> because OCC's proposal establishes

---

<sup>14</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>15</sup> 17 CFR 240.17Ad-22(d)(4).

<sup>16</sup> Id.

policies and procedures designed to identify potential erroneous trades in standardized options and futures options as a source of operational risk and minimize those risks by implementing a process by which potentially erroneous trades may be voided by an options exchange. For the reasons set forth above, the Commission finds that OCC's proposal is consistent with Section 17A(b)(3)(F) of the Act,<sup>17</sup> and Rule 17Ad-22(d)(4) of the Act.<sup>18</sup>

III. Accelerated Approval of the Proposed Rule Change As Modified by Amendment No. 1

The Commission finds good cause, pursuant to Section 19(b)(2)(C)(iii) of the Act,<sup>19</sup> for approving the proposed rule change, as modified by Amendment No. 1, earlier than 30 days after the date of publication of notice in the Federal Register.

As discussed above, OCC filed Amendment No. 1 to clarify that OCC staff would include the 5% intrinsic value threshold in its review to identify which trades should be referred to exchanges for review. OCC also stated that it would review this threshold on a quarterly basis for continued adequacy and any adjustments to the threshold will be the subject of rule filing with the Commission. The 5% intrinsic value threshold should enhance the effectiveness of OCC's review process by reducing the likelihood that valid trades will be referred to the exchanges. Accordingly, given that OCC's proposal should decrease the likelihood that erroneous trades will be submitted to OCC by the exchanges, thereby reducing the risk presented to OCC and further facilitating the accurate clearance

---

<sup>17</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>18</sup> 17 CFR 240.17Ad-22(d)(4).

<sup>19</sup> 15 U.S.C. 78s(b)(2)(C)(iii).



and settlement of securities transactions, the Commission finds good cause to approve the proposed rule change, as modified by Amendment No. 1, on an accelerated basis.

#### 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 e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-OCC-2014-16 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 Number SR-OCC-2014-16. This file number 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 website (<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

website 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 am and 3:00 pm. Copies of the filing also will be available for inspection and copying at the principal office of OCC and on OCC's website at

[http://www.theocc.com/components/docs/legal/rules\\_and\\_bylaws/sr\\_occ\\_14\\_16.pdf](http://www.theocc.com/components/docs/legal/rules_and_bylaws/sr_occ_14_16.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-2014-16 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

V. Conclusion

On the basis of the foregoing, the Commission finds that the proposal is consistent with the requirements of the Act and in particular with the requirements of Section 17A of the Act<sup>20</sup> and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>21</sup> that the proposed rule change (SR-OCC-2014-16), as modified by Amendment No. 1, be, and it hereby is, approved on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>22</sup>

Kevin M. O'Neill  
Deputy Secretary

---

<sup>20</sup> In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>21</sup> 15 U.S.C. 78s(b)(2).

<sup>22</sup> 17 CFR 200.30-3(a)(12).