

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-73343; File No. SR-OCC-2014-805)

October 14, 2014

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of an Advance Notice Concerning Enhancements to the Risk Management Framework Applied to the Clearance of Confirmed Trades Executed in Extended and Overnight Trading Sessions

Pursuant to Section 806(e)(1) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act entitled the Payment, Clearing, and Settlement Supervision Act of 2010<sup>1</sup> (“Payment, Clearing and Settlement Supervision Act”) and Rule 19b-4(n)(1)(i)<sup>2</sup> of the Securities Exchange Act of 1934 notice is hereby given that on September 17, 2014, The Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission (“Commission”) the advance notice as described in Items I and II below, which Items have been prepared by OCC. The Commission is publishing this notice to solicit comments on the advance notice from interested persons.

I. Clearing Agency’s Statement of the Terms of Substance of the Advance Notice

This advance notice is filed by OCC in connection with a proposed change to OCC’s operations that is designed to enhance the risk management framework applied to the clearance of confirmed trades executed in extended and overnight trading sessions (hereinafter, “overnight trading sessions”) offered by exchanges for which OCC provides clearance and settlement services.

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<sup>1</sup> 12 U.S.C. 5465(e)(1).

<sup>2</sup> 17 CFR 240.19b-4(n)(1)(i).

II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Advance Notice

In its filing with the Commission, OCC included statements concerning the purpose of and basis for the advance notice and discussed any comments it received on the advance notice. 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) and (B) below, of the most significant aspects of these statements.

III. (A) Clearing Agency's Statement on Comments on the Advance Notice Received from Members, Participants or Others

Written comments on the advance notice were not and are not intended to be solicited with respect to the advance notice and none have been received.

(B) Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

*Description of Change*

This advance notice is being filed in connection with a proposed change to OCC's operations to enhance the risk management framework applied to the clearance of confirmed trades executed in overnight trading sessions offered by exchanges for which OCC provides clearance and settlement services. OCC currently clears overnight trading activity for CBOE Futures Exchange, LLC ("CFE").<sup>3</sup> The total number of trades submitted to OCC from overnight trading sessions is nominal, typically less than 3,000 contracts per session. However, OCC has recently observed an industry trend whereby

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<sup>3</sup> ELX Futures LP ("ELX") previously submitted overnight trading activity to OCC, but currently does not submit trades from overnight trading sessions to OCC. OCC will re-evaluate ELX's risk controls in the event ELX re-institutes its overnight trading sessions.

exchanges are offering overnight trading sessions beyond traditional hours. Exchanges offering overnight trading sessions have indicated that such sessions benefit market participants by providing additional price transparency and hedging opportunities for products traded in such sessions, which, in turn, promotes market stability.<sup>4</sup>

OCC recently has re-evaluated the risks associated with providing clearing services for overnight trading sessions and, based on such review, is proposing to enhance its risk management framework for clearing overnight trading activity by incorporating a procedure to confirm that the relevant exchanges have implemented certain applicable pre-trade risk controls, complemented by kill-switch capabilities, and minimum exchange operational staffing requirements during overnight trading sessions.<sup>5</sup> OCC also is proposing to implement enhanced monitoring and credit risk controls as well as imposing minimum operational staffing requirements on clearing members that participate in such sessions. These changes (described in greater detail below) are designed to reduce and mitigate the risks associated with clearing trades executed in overnight trading sessions.

OCC's standards for determining whether to provide clearing services for overnight trading sessions offered by an exchange and enhanced risk management framework are designed to work in conjunction with the risk controls of the exchanges that allow overnight trading sessions. OCC will confirm an exchange's risk controls as

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<sup>4</sup> See CFE-2014-010 at <http://cfe.cboe.com/publish/CFERulefilings/SR-CFE-2014-010.pdf>.

<sup>5</sup> The Chicago Board Options Exchange, Incorporated ("CBOE") has approached OCC to provide clearance services for a proposed overnight trading session from 2:00 a.m. to 8:15 a.m. (Central Time) Monday through Friday ("Extended Trading Hours"). CBOE initially plans to list VIX and SPX options during Extended Trading Hours.

well as its staffing levels as they relate to overnight trading sessions to determine if OCC may reasonably rely on such risk controls to reduce risk presented to OCC by the exchange's overnight trading sessions. Such exchange risk controls may consist of: 1) price reasonability checks, 2) controls to prevent orders from being executed beyond a certain percentage (determined by the exchange) from the initial execution price, 3) activity based protections such as a maximum quantity per order and the ability to cancel all quotes when a threshold of contracts are traded in an individual option during a brief window, and 4) kill switch capabilities, which may be initiated by the exchange and can cancel all open quotes or all orders of a particular participant. OCC believes that confirming the existence of applicable pre-trade risk controls as well as overnight staffing at the relevant exchanges is essential to mitigating risks presented to OCC from overnight trading sessions.<sup>6</sup> Providing clearing services to exchanges offering such sessions is consistent with OCC's mission to provide market participants with clearing and risk management solutions that respond to changes in the marketplace. Cleared contract volume also may increase as a result of providing such services.

#### *Enhanced Risk and Operational Controls at OCC*

In order to mitigate the risks associated with the clearance of transactions executed during overnight trading sessions, and to promote robust risk management,

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<sup>6</sup> Comparable controls are applied to futures and future option trades executed in overnight trading sessions currently cleared by OCC, although such controls have been implemented by clearing futures commission merchants ("clearing FCMs") pursuant to Commodity Futures Trading Commission ("CFTC") Regulation 1.73, which also requires such clearing FCMs to monitor for adherence to such controls during regular and overnight trading sessions. OCC believes that it may reasonably rely on such regulation to reduce risk presented to OCC during futures markets overnight trading sessions. *See* 17 CFR 1.73. OCC also confirmed CFE maintains kill switch capabilities.

OCC proposes to implement enhancements to its risk management framework specific to overnight trading sessions. The enhanced risk management framework will include post-trade credit controls that have been designed to identify and mitigate credit risk associated with clearing trades executed during overnight trading sessions as well as requiring clearing members that participate in overnight trading sessions to have operational staff available to OCC during overnight trading sessions.

1. Overnight Monitoring and Credit Controls

OCC plans to implement overnight monitoring and credit controls in order to better monitor clearing members' credit risk during overnight trading sessions. Such monitoring of credit risk is similar to existing OCC practices concerning futures cleared during overnight trading hours and includes automated processes within ENCORE to measure, by clearing member: (i) the aggregate mark-to-market amounts of a clearing member's positions, including positions created during overnight trading, based on current prices using OCC's Portfolio Revaluation system, (ii) the aggregate incremental margin produced by all positions resulting from transactions executed during overnight trading, and (iii) with respect to options cleared during overnight trading hours, the aggregate net trade premium positions resulting from trades executed during overnight trading (each of these measures being a "Credit Risk Number"). ENCORE will generate hourly credit reports, which will contain the Credit Risk Numbers expressed in terms of both dollars and, except for the mark-to-market position values, as a percentage of net capital for each clearing member trading during overnight trading sessions. The Credit Risk Numbers are the same information used by OCC staff to evaluate clearing member exposure during regular trading hours and, in addition to OCC's knowledge of its

clearing members' businesses, are effective measures of the risk presented to OCC by each clearing member. OCC's Operations staff will review such reports as they are generated and, in the event that any of the Credit Risk Numbers for positions established by a clearing member during an overnight trading session exceeds established thresholds, staff will alert OCC's Financial Risk Management staff<sup>7</sup> of the exceedance in accordance with established procedures, as described below. Financial Risk Management staff will follow a standardized process concerning such exceedances, including escalation to OCC's management, if required by such process. Given the nominal volume of trades executed in overnight trading sessions that are presently submitted for clearance, no changes in current staffing levels that support overnight clearing activities is contemplated at this time. However, such staffing levels will be periodically assessed and adjusted, as appropriate.

With respect to OCC's escalation thresholds, if any Credit Risk Number of a clearing member is \$10 million or more, or any Credit Risk Number equals 10% or more of the clearing member's net capital, OCC's Operations staff will be required to provide e-mail notification to Financial Risk Management. If any Credit Risk Number is \$50 million or more, or equals 25% or more of the clearing member's net capital, Operations staff will be required to contact, by telephone: (i) Financial Risk Management staff, (ii) the applicable exchange for secondary review, and (iii) the clearing member's designated contacts. If any Credit Risk Number is \$75 million or more, or equals 50% or more of the clearing member's net capital, Operations staff will be required to contact, by telephone, a designated Senior Vice President or the Chief Risk Officer. Such officer

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<sup>7</sup> OCC's Member Services staff will also receive alerts in order to contact clearing members as may be necessary.

will review the situation and determine whether to issue an intra-day margin call, increase a clearing member's margin requirement in order to prevent the withdrawal of a specified amount of excess margin collateral, if any, the clearing member has on deposit with OCC, whether further escalation is warranted in order for OCC to take protective measures pursuant to OCC Rule 305, as described below or contact the exchange in order to invoke use of its kill switch. OCC chose the above described escalation thresholds based on its analysis of historical overnight trading activity across the futures industry. OCC believes that these thresholds strike an appropriate balance between effective risk monitoring and operational efficiency.

## 2. Operational/Staffing Requirements

In order to mitigate operational risks associated with clearing for overnight trading sessions, clearing members that participate in such trading sessions will be required to provide contact information to OCC for operational personnel available to be contacted by OCC during such sessions. Under OCC Rule 201, each clearing member is required to maintain facilities for conducting business with OCC, and a representative of the clearing member authorized in the name of the clearing member to take all action necessary for conducting business with OCC is required to be available at the facility during such hours as may be specified from time-to-time by OCC. Similarly, OCC Rules 214(c) and (d) require clearing members to ensure that they have the appropriate number of qualified personnel and to maintain the ability to process anticipated volumes and values of transactions. OCC will use this existing authority to require clearing members trading during overnight trading sessions to maintain operational staff that may be contacted by OCC during such sessions. Each morning, shortly after the end of the

overnight trading sessions, ENCORE will generate a report identifying clearing members that participated during that day's overnight trading sessions that have not provided OCC with overnight operational contacts. Clearing members who participated during overnight trading sessions that did not provide operational contacts to OCC, or whose operational contacts for overnight trading sessions were unavailable had OCC attempted to contact such individuals, will be subject to a minor rule violation fine.<sup>8</sup> OCC believes that, by having clearing member operational contacts available during overnight trading hours, operational issues that may arise during such trading hours can quickly be resolved thereby lowering the operational risk presented to OCC by clearing trades executed in overnight trading sessions.

*Existing Risk Controls as They Relate to Overnight Trading Hours*

In addition to implementing enhanced risk management practices specific to clearing trades executed in overnight trading sessions, OCC will apply, and in certain instances modify, existing (or planned) risk management controls to mitigate risks presented by clearance activities, including OCC's ability to issue an intra-day margin call, OCC's performance of a post-trade price reasonableness check and exercising OCC's authority to take protective action pursuant to OCC Rule 305. These controls, as they relate to clearing trades executed in such sessions, are discussed below.

1. Intra-day Margin Call Authority

In order to address credit risk associated with trading during overnight trading sessions, OCC staff will monitor and analyze the impact that positions established during such sessions have on a clearing member's overall exposure. Should the need arise, and

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<sup>8</sup> See OCC Rule 1201(b).



pursuant to OCC Rule 609, OCC may require the deposit of additional margin (“intra-day margin”) by any clearing member that increases its incremental risk as a result of trading activity during overnight trading sessions. Accordingly, a clearing member’s positions established during such sessions will be incorporated into OCC’s intra-day margin process. Should a clearing member’s exposure significantly increase while settlement banks are not open to process an intra-day margin call, OCC has the authority under OCC Rule 601 to increase a clearing member’s margin requirement which would restrict its ability to withdraw excess margin collateral. The implementation of these measures is discussed more fully below.

In the event that a clearing member’s exposure during overnight trading sessions causes a clearing member to exceed OCC’s intra-day margin call threshold for overnight trading sessions, OCC will require the clearing member to deposit intra-day margin equal to the increased incremental risk presented by the clearing member. Specifically, if a clearing member has a total risk charge<sup>9</sup> exceeding 25% (a reduction of the usual figure of 50%), as computed overnight by OCC’s STANS system, and a loss of greater than \$25,000 from an overnight trading session(s), as computed by Portfolio Revaluation, OCC will initiate an intra-day margin call. OCC will know at approximately 8:30 a.m. if it will need to initiate an intra-day margin call on a clearing member based on breaches of these thresholds. This “start of business” margin call is in addition to daily margin OCC collects from clearing members pursuant to OCC Rule 605, any intra-day margin call that

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<sup>9</sup> Total risk charge is a number derived from STANS outputs and is the sum of expected shortfall, stress test charges and any add-on charges computed by STANS. STANS is OCC’s proprietary margin methodology.

OCC may initiate as a result of regular trading sessions or special margin call that OCC may initiate.

In addition to, or instead of, requiring additional intra-day margin, OCC Rule 601<sup>10</sup> and OCC's clearing member margin call policy work together to authorize Financial Risk Management staff to increase a clearing member's margin requirement which may be in an amount equal to an intra-day margin call.<sup>11</sup> (Any increased margin requirement will remain in effect until the next business day.) This action will immediately prevent clearing members from withdrawing any excess margin collateral (in the amount of the increased margin requirement) the clearing member has deposited with OCC. With respect to clearing trades executed in overnight trading sessions, and in the event OCC requires additional margin from a clearing member, Financial Risk Management staff may use increased margin requirements as a means of collateralizing the increase in incremental risk a clearing member incurred during such sessions without having to wait for banks to open to process an intra-day margin call.<sup>12</sup> Such action may be taken by OCC instead of or in addition to issuing an intra-day margin call depending on the amount of excess margin a clearing member has on deposit with OCC and the amount of the incremental risk presented by such clearing member. The expansion of OCC's intra-day margin call process as described in the preceding paragraph, including

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<sup>10</sup> In addition, OCC Rule 601 provides OCC with the authority to fix the margin requirement for any account or any class of cleared contracts at such amount as it deems necessary or appropriate under the circumstances to protect the respective interests of clearing members, OCC and the public.

<sup>11</sup> Clearing members frequently deposit margin at OCC in excess of requirements.

<sup>12</sup> Clearing members would be able to substitute the locked-up collateral during normal time frames (i.e., 6 a.m. to 5 p.m. (Central Time) for equity securities).

OCC's ability to manually increase clearing members' margin requirements, will mitigate the risk that OCC is under-collateralized as a result of overnight trading hours.

## 2. Post-Trade Price Reasonableness

In a separate pending rule filing, OCC has proposed to add an interpretation and policy concerning its administration of Article VI, Section 7(c) of its 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.<sup>13</sup> The new Interpretation and Policy to Article VI, Section 7(c) will allow OCC to review the reasonableness of prices for options transactions reported as confirmed trades and ask reporting exchanges to consider whether new or revised trade information is required to properly clear the transaction.<sup>14</sup> To promote OCC's ability to protect itself and clearing members from the negative effects of clearing trades in options that may contain erroneous premium information, OCC will apply a premium price threshold to accepted trades that will trigger further scrutiny of certain trades that exceed the threshold. This premium price threshold will apply to trades occurring during overnight trading sessions, upon regulatory approval, and thus will increase OCC's ability to monitor and mitigate risk arising from clearing trades executed during such trading sessions.

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<sup>13</sup> Exchange Act Release No. 32718 (July 30, 2014), 79 FR 45527(August 5, 2014) (SR-OCC-2014-16). This filing, as amended, is pending regulatory approval.

<sup>14</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).

### 3. Protective Action Pursuant to OCC Rule 305

Pursuant to OCC Rule 305, the Executive Chairman or the President of OCC, in certain situations, has the authority to impose limitations and restrictions on the transactions, positions and activities of a clearing member. This authority will be used, as needed, in the event a clearing member accumulates significant credit risk during overnight trading sessions, or a clearing member's activities during such trading sessions otherwise warrant OCC taking protective action.

#### ***Anticipated Effect on and Management of Risk***

Clearing transactions executed in overnight trading sessions may increase risk presented to OCC due to the period of time between trade acceptance and settlement, the staffing levels at clearing members during such trading sessions and the deferment of executing intra-day margin calls until banking settlement services are operational. However, OCC will expand its risk management practices in order to mitigate these risks by implementing, and expanding, the various tools discussed above. For example, OCC will modify its existing risk management practices in order to closely monitor clearing members' credit risk from trades placed during overnight trading sessions as well as implement processes so that OCC takes appropriate action when such credit risk exceeds certain limits. OCC will also use its existing authority to require adequate clearing member staffing during such trading sessions, which will mitigate the operational risk associated with clearing members trading while they are not fully staffed. These risk management functions will work in tandem with risk controls, including the implementation of kill switch capabilities, adopted by the exchanges operating overnight trading sessions or by clearing FCMs, as applicable.

In addition to the above, OCC will adapt existing processes so that such processes can be used to mitigate risk associated with overnight trading sessions. Specifically, OCC will have the ability to issue margin calls, and prevent the withdrawal of excess margin on deposit at OCC, as a result of activity during such trading sessions as a means of reducing risk. OCC also will apply, pending regulatory approval, a post-trade price reasonability check to trades reported during overnight trading sessions, and therefore mitigate the risk of losses from erroneous trades. Finally, OCC will be able to take protective action pursuant to OCC Rule 305 as a result of clearing member activity during such sessions.

***Consistency with the Payment, Clearing and Settlement Supervision Act***

OCC believes that the proposed change is consistent with Section 805(b) of the Payment, Clearing and Settlement Supervision Act<sup>15</sup> because the proposed change will promote robust risk management.<sup>16</sup> OCC believes that the proposed enhancements to its risk management functions will provide OCC with the tools necessary to mitigate risks that may occur as a result of overnight trading sessions. As described above, OCC will implement new risk monitoring processes designed to identify increases in credit risk presented to OCC as a result of such sessions as well as implement changes designed to mitigate operational risk associated with overnight trading sessions. In addition, OCC will adapt certain existing practices to accommodate these overnight trading sessions including its margin call process and its authority to take protective action pursuant to OCC Rule 305. The new and modified practices are designed to identify and mitigate

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<sup>15</sup> 12 U.S.C. 5464(b).

<sup>16</sup> 12 U.S.C. 5464(b)(1).

risks that may be presented to OCC as a result of overnight trading sessions and thereby promote robust risk management.

III. Date of Effectiveness of the Advance Notice and Timing for Commission Action

The proposed change may be implemented if the Commission does not object to the proposed change within 60 days of the later of (i) the date that the Commission receives the notice of proposed change, or (ii) the date the Commission receives any further information it requests for consideration of the notice. The clearing agency shall not implement the proposed change if the Commission has any objection to the proposed change.

The Commission may extend the period for review by an additional 60 days if the proposed change raises novel or complex issues, subject to the Commission providing the clearing agency with prompt written notice of the extension. A proposed change may be implemented in less than 60 days from the date the advance notice is filed, or the date further information requested by the Commission is received, if the Commission notifies the clearing agency in writing that it does not object to the proposed change and authorizes the clearing agency to implement the proposed change on an earlier date, subject to any conditions imposed by the Commission.

The clearing agency shall post notice on its website of proposed changes that are implemented.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing. 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-2014-805 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-2014-805. 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 advance notice that are filed with the Commission, and all written communications relating to the advance notice 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

[http://www.theocc.com/components/docs/legal/rules\\_and\\_bylaws/sr\\_occ\\_14\\_805.pdf](http://www.theocc.com/components/docs/legal/rules_and_bylaws/sr_occ_14_805.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-2014-805 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

By the Commission.

Kevin M. O'Neill  
Deputy Secretary