SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-74268; File No. SR-OCC-2014-24)

February 12, 2015

Self-Regulatory Organizations; The Options Clearing Corporation; Order Approving Proposed Rule Change Concerning Extended and Overnight Trading Sessions

On December 12, 2014, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("Commission") the proposed rule change SR-OCC-2014-24 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act") [1] and Rule 19b-4 thereunder.[2] The proposed rule change was published for comment in the Federal Register on December 30, 2014.[3] The Commission did not receive any comments on the proposed rule change. This order approves the proposed rule change.

I. Description

This rule change was filed in connection with OCC's proposed change to its operations concerning 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

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

2 17 CFR 240.19b-4. OCC also filed this change as an advance notice under Section 806(e)(1) of the Payment, Clearing, and Settlement Supervision Act of 2010. 12 U.S.C. 5465(e)(1). Securities Exchange Act Release No. 74073 (January 15, 2015), 80 FR 3287 (January 22, 2014) (SR-OCC-2014-812). The Commission did not receive any comments on the advance notice.

3 Securities Exchange Act Release No. 73907 (December 22, 2014), 79 FR 78543 (December 30, 2014) (SR-OCC-2014-24).

("CFE").[4] 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 exchanges are offering overnight trading sessions beyond traditional hours. Exchanges offering overnight trading sessions have indicated to OCC 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.[5] In light of this trend, OCC proposed to implement a framework for clearing trades executed in such sessions that includes: 1) qualification criteria used to approve clearing members for overnight trading sessions, 2) systemic controls to identify trades executed during overnight trading sessions by clearing members not approved for such sessions, 3) enhancements to OCC's overnight monitoring of trades submitted by exchanges during overnight trading sessions, 4) enhancements to OCC's credit controls with respect to monitoring clearing members' credit risk during overnight trading sessions, including procedures for contacting an exchange offering overnight trading sessions in order to invoke use of the exchange's kill switch, and 5) taking appropriate disciplinary action against clearing members who attempt to clear during the overnight trading sessions without first obtaining requisite approvals. These changes (described in greater detail below) are designed to reduce and mitigate the risks associated with clearing trades executed in overnight trading sessions.

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[4] 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.

[5] *See* CFE-2014-010 at http://cfe.cboe.com/publish/CFErulefilings/SR-CFE-2014-010.pdf

In addition, the only products that will be eligible for clearing in the overnight trading sessions are index options and index futures products.

OCC's framework for determining whether to provide clearing services for overnight trading sessions offered by an exchange is designed to work in conjunction with the risk controls of the exchange that offers overnight trading sessions. OCC will confirm an exchange's risk controls as well as its staffing levels as they relate to overnight trading sessions to determine if OCC may reasonably rely on such risk controls to the reduce risk presented to OCC by the exchange's overnight trading sessions. Such exchange risk controls will 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 which focus on risk beyond price, such as a high number of trades occurring in a set period of time; 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.[6] OCC believes that providing clearing services to exchanges offering such

[6] 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. This requires clearing FCMs to monitor for adherence to such controls during regular and overnight trading sessions. Some of the risk control measures are similar to those proposed by OCC for use in clearing securities trades in overnight trading sessions. For instance, OCC confirmed that CFE maintains kill switch capabilities.

sessions is consistent with OCC's mission to provide market participants with clearing and risk management solutions that respond to changes in the marketplace.

Qualification Criteria

In order to mitigate 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 and risk personnel available to be contacted by OCC during such sessions. In addition, OCC will require that clearing members participating in an overnight trading session post additional margin in a designated account in order to mitigate the risk that OCC cannot draft a clearing member's bank account during an overnight trading session.[7] OCC also will adopt a procedure whereby, on a quarterly basis, it confirms its record of clearing members eligible for overnight trading sessions with a similar record maintained by exchanges offering such overnight trading sessions.

With respect to providing operational and risk contacts, under OCC Rule 201, each clearing member is required to maintain facilities for conducting business with OCC and to have a representative authorized in the name of the clearing member to take all action necessary for conducting business with OCC 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

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7 Clearing members will be required to designate a firm account to ensure that OCC has a general lien on the assets in the account and can use them to satisfy any obligation of the clearing member to OCC.

during overnight trading sessions to maintain operational and risk staff that may be contacted by OCC during such sessions.

OCC will impose upon clearing members qualified to participate in overnight trading sessions additional margin requirement in an amount of the lesser of $10 million or 10% of the clearing member's net capital ("Additional Margin"), which will be equal to the first monitoring risk threshold (described below) and which will be collected the morning before each overnight trading sessions. Clearing members must identify the proprietary account that would be charged the Additional Margin amount. The Additional Margin requirement is intended to provide OCC with additional margin assets should a clearing member's credit risk increase during overnight trading sessions.[8] OCC will adopt a process whereby each morning OCC Financial Risk Management staff will assess the Additional Margin requirement prior to participating in any future overnight trading sessions against clearing members eligible to participate in overnight trading sessions. Clearing members that do not have sufficient excess margin on deposit with OCC to meet the Additional Margin amount will be required to deposit additional funds with OCC to satisfy the Additional Margin requirement.[9] This process will be adopted under existing rule authority.

Moreover, OCC also will confirm that an exchange offering overnight trading sessions has adopted a procedure whereby such exchange would contact OCC when a

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[8] Clearing members approved for overnight trading sessions who do not meet the Additional Margin requirement for a given overnight trading session will be treated like a clearing member not approved overnight trading sessions, as described below.

[9] Under OCC Rule 601, OCC has the discretion to fix the margin requirement for any account at an amount that it deems necessary or appropriate under the circumstances to protect the interests of clearing members, OCC and the public.

trader requests trading privileges during overnight trading sessions. The purpose of this contact is to verify that the trader's clearing firm (*i.e.*, the OCC clearing member) is approved for overnight trading sessions. If the applicable OCC clearing member is not approved for overnight trading sessions, then the clearing member must receive OCC's approval for overnight trading sessions, or the exchange will not provide the trader trading privileges during overnight trading sessions. Moreover, OCC will confirm that an exchange offering overnight trading sessions has implemented a procedure to periodically (*i.e.*, quarterly) validate its record of approved clearing firms against OCC's record of clearing members approved for overnight trading sessions.[10] Any discrepancies between the two records will be promptly resolved by either the clearing member obtaining approval from OCC for overnight trading sessions, or by the exchange revoking the clearing firm's trading privileges for overnight trading sessions.

Systemic Controls

OCC will implement system changes so that trades submitted to OCC during overnight trading sessions that have been executed by clearing members not approved for such trading sessions will be reviewed by OCC staff after acceptance but before being processed (each such trade being a "Reviewed Trade"). OCC will contact the submitting exchange regarding each Reviewed Trade in order to determine if the trade is a valid trade. If the exchange determines that the Reviewed Trade was in error such that, as provided in Article VI, Section 7(c) of OCC's By-laws, new or revised trade information is required to properly clear the transaction, OCC expects the exchange would instruct

[10] As discussed in more detail below, clearing members that attempt to participate in overnight trading sessions without the necessary approval will be subject to a minor rule violation fine.

OCC to disregard or "bust" the trade. If the exchange determines that the Reviewed Trade was not in error, then OCC will clear the Reviewed Trade and take appropriate disciplinary action against the non-approved clearing member, as described below. OCC believes that clearing the Reviewed Trade is appropriate in order to avoid potentially harming the clearing member approved for overnight trading sessions that is on the opposite side of the transaction.

Overnight Monitoring

OCC will implement additional overnight monitoring 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 OCC's clearing 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"). Hourly credit reports would be generated by ENCORE containing 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 exceed established thresholds, staff will alert OCC's Market Risk staff[11] of the exceedance in accordance with established procedures, as described below.

Market Risk 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, OCC does not contemplate changes in its current staffing levels that support overnight clearing activities at this time, however, OCC will periodically assess and adjust such staffing levels, as appropriate. As part of the overnight clearing activities, OCC has, however, designated an on-call Market Risk duty officer who would be responsible for reviewing issues that arise when clearing for overnight trading session and determining what measures to be taken as well as additional escalation, if necessary.

With respect to OCC's escalation thresholds, if any Credit Risk Number of a clearing member approved for overnight trading sessions 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 Market Risk and Member Services staff. If any Credit Risk Number of a clearing member not approved for overnight trading sessions is $10 million or more, or any Credit Risk Number equals

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[11] OCC's Member Services staff will also receive alerts in order to contact clearing members as may be necessary.

10% or more of the clearing member's net capital, OCC's Operations will also notify Market Risk and Member Services staff as well as its senior management. Such departments will take action to prevent additional trading by the non-approved clearing member, including contacting the exchange to invoke use of the exchange's kill switch.

If any Credit Risk Number of a clearing member approved for overnight trading sessions 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) Market Risk and Member Services, (ii) the applicable exchange for secondary review, and (iii) the clearing member's designated contacts. The on-call Market Risk duty officer also will consider if additional action is necessary, which may include contacting a designated executive officer in order to issue an intra-day margin call, increase the 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 or contacting the exchange in order to invoke the use of its kill switch.

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, Market Risk staff, the on-call Market Risk duty officer and a designated executive officer. Such officer will be responsible for reviewing the situation and determining whether to implement credit controls, which are described in greater detail below and include: issuing an intra-day margin call, increasing 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, or contact the exchange in order to invoke use of its kill switch. OCC stated that it 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.

Credit Controls

In order to address credit risk associated with trading during overnight trading sessions, and as described above, OCC will collect Additional Margin from clearing members as well as monitor and analyze the impact that positions established during such sessions have on a clearing member's overall exposure. Should the need arise based on threshold breaches described above, and 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. Further, if a clearing member's exposure significantly increases during a time when settlement banks are not open to process an intra-day margin call, OCC will use its current authority under OCC Rule 601 to increase a clearing member's margin requirement, which will restrict the clearing member's 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[12] exceeding 25% (a reduction of the usual figure of 50%), as computed overnight by OCC's STANS system, and a loss of greater than $50,000 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. (Central Time) if an intra-day margin call on a clearing member will be initiated 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 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[13] and OCC's Clearing Member Margin Call Policy will work together to authorize Market Risk staff to increase a clearing member's margin requirement which may be in an amount equal to an intra-day margin call.[14] (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

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12 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.

13 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.

14 Clearing members frequently deposit margin at OCC in excess of requirements.

respect to clearing trades executed in overnight trading sessions, and in the event OCC requires additional margin from a clearing member, Market Risk 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.[15] 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. OCC believes that the expansion of its intra-day margin call process as described in the preceding paragraph, including 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.

Moreover, a designated executive officer may call an exchange offering overnight trading sessions to invoke the use of its kill switch. The kill switch prevents a clearing member (or the market participant clearing through a clearing member) from executing trades on the exchange during a given overnight trading session or, if needed, stop all trading during a given overnight trading session. Finally, 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

15 Clearing members will be able to substitute the locked-up collateral during normal time frames (*i.e.*, 6:00 a.m. to 5:00 p.m. (Central Time) for equity securities).

member's activities during such trading sessions otherwise warrant OCC taking protective action.

Rule Enforcement Actions

In order to deter clearing members from attempting to participate in overnight trading sessions without authorization as well as appropriately enforce the above described processes, OCC will ensure that any attempt by a clearing member to participate in overnight trading sessions without first obtaining the necessary approval will result in the initiation of a rule enforcement action against such clearing member. As described above, clearing members not approved for overnight trading sessions that trade during such overnight sessions will have their trades reviewed by OCC staff. Clearing members that attempt to participate in overnight trading sessions but not obtain the necessary approval to do so will be subject to a minor rule violation fine.[16] In addition, if a clearing member's operational or risk contacts for overnight trading sessions were unavailable had OCC attempted to contact such individuals, the clearing member will be subject to a minor rule violation fine. OCC has existing processes in place to monitor for clearing member violations of OCC's rules and such processes will also apply to clearing member activity during overnight trading sessions.

II. Discussion and Commission Findings

Section 19(b)(2)(C) of the Act[17] directs the Commission to approve a proposed rule change of a self-regulatory organization if it finds that the proposed rule change is

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16 *See* OCC Rule 1201(b).

17 15 U.S.C. 78s(b)(2)(C).

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,[18] which requires, among other things, that the rules of a clearing agency are 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. Although clearing transactions executed in overnight trading sessions may present additional risk to OCC and the markets in general, OCC's proposal is designed to monitor and mitigate these risks and thus assure the safeguarding of securities and funds which are in OCC's custody or control or for which it is responsible.

By limiting the product set eligible for overnight trading sessions to index options and index futures products and by instituting qualification criteria for determining whether to provide clearing services for overnight trading sessions offered by a particular exchange, OCC should be able to better assure the safeguarding of securities and funds which are in its custody or control. In addition, in order to address the risks associated with extended trading hours, including those associated with OCC and clearing members' inability to transfer funds to satisfy margin during overnight hours, OCC's proposed framework, which includes a number of mechanisms designed to further control the risks and safeguard securities and funds, should also facilitate the safeguarding of securities and funds. These mechanisms include (i) clearing member qualification criteria; (ii) systemic controls to identify trades executed by clearing members not approved for overnight trading; (iii) enhancements to OCC's overnight monitoring of trades submitted

[18] 15 U.S.C. 78q-1(b)(3)(F).

by exchanges during overnight trading sessions; (iv) enhancements to OCC's credit controls with respect to monitoring clearing members' credit risk during overnight trading sessions; and (v) disciplinary actions for unapproved clearing members who attempt to clear during overnight trading sessions.

In particular, OCC's overnight monitoring and escalation mechanism, which includes the ability for OCC to require additional intra-day margin, increase a clearing member's margin requirement, invoke an exchange's kill switch, or use any combination thereof, should provide OCC with the necessary mechanisms to ensure securities and funds which are in its custody or control. The obligation for OCC and clearing members to maintain and enforce adequate staffing by employing the use of a designated an on-call Market Risk duty officer should also help assure that clearing activities and margin levels are being adequately monitoring during the overnight trading hours, which in turn should facilitate the safeguarding of securities and funds which are in the custody or control of OCC or for which it is responsible.

III. 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[19] and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[20] that the proposed rule change (SR-OCC-2014-24) be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[21]

Brent J. Fields
Secretary

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19 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).

20 15 U.S.C. 78s(b)(2).

21 17 CFR 200.30-3(a)(12).