

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-81260; File Nos. SR-NSCC-2017-803; SR-OCC-2017-804)

July 31, 2017

Self-Regulatory Organizations; National Securities Clearing Corporation; The Options Clearing Corporation; Notice of No Objection to Advance Notices Concerning the Adoption of a New Stock Options and Futures Settlement Agreement Between the National Securities Clearing Corporation and The Options Clearing Corporation

On June 1, 2017, National Securities Clearing Corporation (“NSCC”) and The Options Clearing Corporation (“OCC,” each a “Clearing Agency,” and collectively, “Clearing Agencies”) filed with the Securities and Exchange Commission (“Commission”) advance notices SR-NSCC-2017-803 and SR-OCC-2017-804 respectively (collectively, the “Advance Notices”), 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 (“Clearing Supervision Act”)¹ and Rule 19b-4(n)(1)(i) under the Securities Exchange Act of 1934 (“Act”).² The Advance Notices were published for comment in the Federal Register on July 5, 2017.³

¹ 12 U.S.C. 5465(e)(1).

² 17 CFR 240.19b-4(n)(1)(i).

³ Securities Exchange Act Release Nos. 81039 (June 28, 2017), 82 FR 31123 (July 5, 2017) (SR-NSCC-2017-803); 81040 (June 28, 2017), 82 FR 31109 (July 5, 2017) (SR-OCC-2017-804). The Clearing Agencies also filed proposed rule changes with the Commission pursuant to Section 19(b)(1) of the Act and Rule 19b-4 thereunder, seeking approval of changes to their Rules necessary to implement the proposal. 15 U.S.C. 78s(b)(1) and 17 CFR 240.19b-4, respectively. The proposed rule changes were published for comment in the Federal Register on June 20, 2017. Securities Exchange Act Release Nos. 80942 (June 15, 2017), 82 FR 28141 (June 20, 2017) (SR-NSCC-2017-007); 80941 (June 15, 2017), 82 FR 28207 (June 20, 2017) (SR-OCC-2017-013). The Commission received one comment letter to SR-OCC-2017-013. See letter from Pamela D. Marler, dated June 30, 2017. Such comment letter does not specifically comment on any aspect of the proposed rule changes.

The Commission did not receive any comments to the Advance Notices. This publication serves as notice that the Commission does not object to the changes set forth in the Advance Notices.

I. Description of the Advance Notices

The Advance Notices filed by the Clearing Agencies are a proposal to implement a new Stock Options and Futures Settlement Agreement (“New Accord”) between the Clearing Agencies, and to amend the Rules and Procedures of NSCC (“NSCC Rules”) and the By-Laws and Rules of OCC to accommodate the proposed provisions of the New Accord.⁴

Background

OCC issues and clears U.S.-listed options and futures on a number of underlying financial assets including common stocks, currencies and stock indices. OCC’s Rules, however, provide that delivery of, and payment for, securities underlying certain physically settled stock options and single stock futures cleared by OCC are effected through the facilities of a correspondent clearing corporation (i.e., NSCC) and are not settled through the facilities of OCC. To enable this arrangement concerning stock options, the Clearing Agencies currently are parties to a Third Amended and Restated Options Exercise Settlement Agreement, dated February 16, 1995, as amended (“Existing Accord”),⁵ which governs the delivery and receipt of stock resulting from the exercise

⁴ Terms not defined herein are defined in the NSCC Rules, available at http://www.dtcc.com/~media/Files/Downloads/legal/rules/nsc_rules.pdf, or in OCC’s By-Laws and Rules, available at <http://optionsclearing.com/about/publications/bylaws.jsp>, as the context implies.

⁵ The Existing Accord and the proposed changes thereunder were previously approved by the Commission. See Securities Exchange Act Release No. 37731

and assignment of stock options (i.e., put and call options issued by OCC (“Stock Options”)). Pursuant to the Existing Accord, such stock must be: (i) eligible for settlement through NSCC’s Continuous Net Settlement (“CNS”) Accounting Operation and (ii) designated to settle on the third business day following the date the related exercise or assignment is accepted by NSCC (“Options E&A”), which is the current standard settlement cycle, known as “regular way” settlement.⁶ All OCC Clearing Members that intend to engage in Stock Options transactions are required to also be

(September 26, 1996), 61 FR 51731 (October 3, 1996) (SR-OCC-96-04 and SR-NSCC-96-11) (Order Approving Proposed Rule Change Related to an Amended and Restated Options Exercise Settlement Agreement Between the Options Clearing Corporation and the National Securities Clearing Corporation); Securities Exchange Act Release No. 43837 (January 12, 2001), 66 FR 6726 (January 22, 2001) (SR-OCC-00-12) (Order Granting Accelerated Approval of a Proposed Rule Change Relating to the Creation of a Program to Relieve Strains on Clearing Members’ Liquidity in Connection With Exercise Settlements); and Securities Exchange Act Release No. 58988 (November 20, 2008), 73 FR 72098 (November 26, 2008) (SR-OCC-2008-18 and SR-NSCC-2008-09) (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).

⁶ According to the Clearing Agencies, regular way settlement is understood to be the financial services industry’s standard settlement cycle. Currently, regular way settlement of securities underlying Stock Options and stock futures takes place on the third business day following the date the related exercise, assignment or delivery obligation is accepted by NSCC. On or prior to September 5, 2017, the standard settlement cycle will be shortened to two business days after trade date, as required by the Commission. See Securities Exchange Act Release No. 80295 (March 22, 2017), 82 FR 15564 (March 29, 2017) (S7-22-16) (Securities Transaction Settlement Cycle). NSCC has amended its Rules with respect to the meaning of regular way settlement to be consistent with the shorter standard settlement cycle and will establish an effective date for these rule changes in a subsequent rule filing. See Securities Exchange Act Release No. 79734 (January 4, 2017), 82 FR 3030 (January 10, 2017) (SR-NSCC-2016-007).

Members of NSCC or to have appointed or nominated an NSCC Member to act on its behalf.⁷

The Advance Notices are a proposal by the Clearing Agencies to adopt a New Accord, which would provide for the settlement of the securities underlying certain Stock Options and delivery obligations arising from certain matured physically-settled single stock futures contracts cleared by OCC (“Stock Futures”). The New Accord would implement three major changes. First, the New Accord would expand the category of securities that would be eligible for settlement and guaranty under the agreement to certain securities (including stocks, exchange-traded funds and exchange-traded notes) that (i) are required to be delivered in the exercise and assignment of Stock Options and are eligible to be settled through NSCC’s Balance Order Accounting Operation or (ii) are delivery obligations arising from Stock Futures that have reached maturity and are eligible to be settled through NSCC’s CNS Accounting Operation or Balance Order Accounting Operation.⁸ Second, the New Accord would modify the time of the transfer of responsibilities from OCC to NSCC and, specifically, when OCC’s guarantee obligations under OCC’s By-Laws and Rules with respect to such transactions (“OCC’s Guaranty”) end and NSCC’s obligations under Addendum K of the NSCC Rules with respect to such transactions (“NSCC’s Guaranty”) begin, i.e., when the “Guaranty Substitution” takes place. Third, the New Accord would put additional arrangements into place concerning the procedures, information sharing, and overall governance processes

⁷ A firm that is both an OCC Clearing Member and an NSCC Member, or is an OCC Clearing Member that has designated an NSCC Member to act on its behalf is referred to herein as a “Common Member.”

⁸ The New Accord would continue to provide for the settlement of securities underlying Stock Options that settle through NSCC’s CNS Accounting Operation.

under the agreement. The Clearing Agencies propose to make certain clarifying and conforming changes to the NSCC Rules and the OCC By-Laws and Rules as necessary to implement the New Accord.

According to the Clearing Agencies, the primary purpose of the proposed changes is to: (1) provide consistent treatment across all expiries for products with regular way⁹ settlement cycle specifications; (2) reduce the operational complexities of the Existing Accord by delineating a single point in time at which OCC's Guaranty ceases and NSCC's Guaranty begins and clarifying the roles and responsibilities of the Clearing Agencies in the event of a default of a Common Member at either or both Clearing Agencies; and (3) improve procedures, information sharing, and overall governance under the agreement.

The New Accord would become effective, and wholly replace the Existing Accord, at a date specified in a service level agreement to be entered into between the Clearing Agencies.¹⁰

The Existing Accord

Key Terms of the Existing Accord

According to the Clearing Agencies, under the Existing Accord, the settlement of underlying securities resulting from Options E&A generally proceeds according to the following sequence of events. NSCC maintains and delivers to OCC a list ("CNS

⁹ Under the New Accord, "regular way settlement" would have a meaning agreed to by the Clearing Agencies. This will address any changes to the standard settlement cycle. See supra note 6.

¹⁰ Such effective date would be a date following approval of all required regulatory submissions to be filed by OCC and NSCC with the appropriate regulatory authorities, including these Advance Notices. See supra note 3.

Eligibility Master File”) that enumerates all CNS Securities, which are defined in NSCC Rule 1 and generally include securities that have been designated by NSCC as eligible for processing through NSCC’s CNS Accounting Operation and eligible for book entry delivery at NSCC’s affiliate, The Depository Trust Company (“CNS Eligible Securities”).¹¹ OCC, in turn, uses this file to make a final determination of which securities NSCC would not accept and therefore would need to be settled on a broker-to-broker basis. OCC then sends to NSCC a transactions file (“OCC Transactions File”),¹² listing the specific securities that are to be delivered and received as a result of Options E&A that have not previously been reported to NSCC and for which settlement is to be made through NSCC.¹³ With respect to each Options E&A, the OCC Transactions File includes the CUSIP number of the security to be delivered, the identities of the delivering and receiving Common Members, the quantity to be delivered, the total value of the quantity to be delivered based on the exercise price of the option for which such security is the underlying security, and the exercise settlement date. After receiving the OCC Transactions File, NSCC then has until 11:00 AM Central Time on the following business day to reject any transaction listed in the OCC Transactions File. NSCC can

¹¹ Supra note 4.

¹² According to the Clearing Agencies, delivery of the OCC Transactions File with respect to an Options E&A typically happens on the date of the option’s exercise or expiration, though this is not expressly stated in the Existing Accord. However, in theory, an Options E&A could, due to an error or delay, be reported later than the date of the option’s exercise or expiration.

¹³ According to the Clearing Agencies, this process would be substantially the same under the New Accord with the exception that the CNS Eligibility Master File and OCC Transactions File would be renamed and would be expanded in scope to include additional securities that would be eligible for guaranty and settlement under the New Accord, as discussed in further detail below.

reject a transaction if the security to be delivered has not been listed as a CNS Eligible Security in the CNS Eligibility Master File or if information provided in the OCC Transactions File is incomplete. Otherwise, if NSCC does not so notify OCC of its rejection of an Options E&A by the time required under the Existing Accord, NSCC will become unconditionally obligated to effect settlement of the underlying securities resulting from Options E&A.

According to the Clearing Agencies, under the Existing Accord, even after NSCC's trade guarantee has taken effect,¹⁴ OCC retains its trade guarantee obligations with respect to the Options E&A until certain deadlines¹⁵ have passed on the first business day following the scheduled settlement date. Once such deadlines have passed, OCC is released from its trade guarantee unless NSCC has notified OCC that the relevant Common Member has failed to meet an obligation to NSCC or NSCC has ceased to act for such Common Member pursuant to the NSCC Rules.¹⁶ As a result, there is a period of time during which NSCC's trade guarantee overlaps with OCC's trade guarantee and for which both Clearing Agencies collect and hold margin from the Common Member.

¹⁴ Pursuant to Addendum K of the NSCC Rules, NSCC guarantees the completion of CNS transactions and balance order transactions that have reached the point at which, for bi-lateral submissions by Members, such trades have been validated and compared by NSCC, and for locked-in submissions, such trades have been validated by NSCC, as described in the NSCC Rules. Transactions that are covered by the Existing Accord, and that would be covered by the New Accord, are expressly excluded from the timeframes described in Addendum K. See supra note 4.

¹⁵ The deadline is 6:00 AM Central Time for NSCC notifying OCC of a Common Member failure and, if NSCC does not immediately cease to act for such defaulting Common Member, 4:00 PM Central Time for notifying OCC that NSCC has ceased to act.

¹⁶ See NSCC Rule 46 (Rule 46 (Restrictions on Access to Services)). See supra note 4.

In the event that NSCC or OCC ceases to act on behalf of or suspends a Common Member, that Common Member would become a “defaulting member.” Once a Common Member becomes a defaulting member, the Existing Accord provides that if OCC were to suspend a Common Member, NSCC would be required to make a payment to OCC equal to the lesser of OCC’s total loss resulting from the closeout or the positive mark-to-market (“MTM”) amount relating to the defaulting member’s Options E&A and that if NSCC were to suspend a Common Member, OCC would be required to make a payment to NSCC equal to the lesser of NSCC’s total loss resulting from closeout or the negative mark-to-market amount relating to the defaulting member’s Options E&A. A Clearing Agency must request the transfer of any such payments by the close of business on the tenth business day following the day of default and, after a request is made, the other Clearing Agency is required to make payment within five business days of the request.

The New Accord

Overview

As noted above, the Clearing Agencies propose to adopt a New Accord, which would provide for the settlement of certain securities underlying Stock Options and Stock Futures transactions. According to the Clearing Agencies, the New Accord is primarily designed to, among other things, expand the category of securities that are eligible for settlement and guaranty under the agreement; simplify the time of the transfer of responsibilities from OCC to NSCC (specifically, the Guaranty Substitution); and put additional arrangements into place concerning the procedures, information sharing, and

overall governance processes under the agreement. The material provisions of the New Accord are described in detail below.

Key Elements of the New Accord

Expanded Scope of Eligible Securities

Pursuant to the proposed New Accord, on each day that both OCC and NSCC are open for accepting trades for clearing (“Activity Date”), NSCC would deliver to OCC an “Eligibility Master File,” which would identify the securities, including stocks, exchange-traded funds and exchange-traded notes, that are: (1) eligible to settle through NSCC’s CNS Accounting Operation (as is currently the case under the Existing Accord) or NSCC’s Balance Order Accounting Operation (which is a feature of the New Accord) and (2) required to be physically delivered in settlement of (i) exercises and assignments of Stock Options (as is currently the case under the Existing Accord) or (ii) delivery obligations arising from maturing physically settled Stock Futures (which is a feature of the New Accord) (all such securities collectively being “Eligible Securities”). OCC, in turn, would deliver to NSCC its file of E&A/Delivery Transactions¹⁷ that list the Eligible Securities to be delivered, or received, and for which settlement is proposed to be made through NSCC on that Activity Date. Guaranty Substitution (discussed further below) would not occur with respect to an E&A/Delivery Transaction that is not submitted in the

¹⁷ “E&A/Delivery Transactions” are transactions involving the settlement of securities underlying Stock Options and Stock Futures under the New Accord. The delivery of E&A/Delivery Transactions to NSCC would replace the delivery of the “OCC Transactions File” from the Existing Accord. The actual information delivered by OCC to NSCC would be the same as is currently provided on the OCC Transactions File, but certain additional terms would be included to accommodate the inclusion of Stock Futures, along with information regarding the date that the instruction to NSCC was originally created and the E&A/Delivery Transaction’s designated settlement date.

proper format or that involves a security that is not identified as an Eligible Security on the then-current Eligibility Master File. This process is similar to the current process under the Existing Accord with the exception of the expanded scope of Eligible Securities (and additional fields necessary to accommodate such securities) that would be listed on the Eligibility Master File and the E&A/Delivery Transactions file.

As with the Existing Accord, the proposed New Accord would continue to provide for the settlement of securities underlying Stock Options that settle through NSCC's CNS Accounting Operation and are designated to settle regular way. In addition, the New Accord would expand the category of securities eligible for settlement and guarantee by NSCC to include Stock Futures deliveries that are eligible to settle through NSCC's CNS Accounting Operation and are designated to settle regular way. The New Accord would also provide for the settlement of securities underlying both Stock Options and Stock Futures that are eligible to settle through NSCC's Balance Order Accounting Operation on a regular way basis. The primary purpose of expanding the category of securities that are eligible for settlement and guaranty under the agreement is to provide consistent treatment across all expiries for products with regular way settlement cycle specifications and simplify the settlement process for these additional securities transactions.

The New Accord would not apply to Stock Options or Stock Futures that are designated to settle on a shorter timeframe than the regular way settlement timeframe. These Stock Options would continue to be processed and settled as they would be today, outside of the New Accord. The New Accord also would not apply to any Stock Options or Stock Futures with underlying securities that are neither CNS Securities nor Balance

Order Securities.¹⁸ Transactions in these securities are, and would continue to be processed on a trade-for-trade basis away from NSCC's facilities. Such transactions may utilize other NSCC services for which they are eligible, but would not be subject to the New Accord.¹⁹

Proposed Changes Related to Guaranty Substitution

The New Accord would adopt a fundamentally different approach to the delineation of the rights and responsibilities of the Clearing Agencies with respect to Guaranty Substitution.

As described above, the Existing Accord provides that, following the default of a Common Member, and depending on the timing of the exercise or assignment guarantee, the Clearing Agency that suspends the Common Member will receive payment from the other Clearing Agency to compensate for potential losses incurred in connection with the Common Member's default. The proposed New Accord, in contrast, would clearly delineate a point in time at which OCC's Guaranty ends and NSCC's Guaranty begins (i.e., the Guaranty Substitution takes place) with respect to E&A/Delivery Transactions. By focusing on the timing of the Guaranty Substitution, rather than payment from one Clearing Agency to the other, the New Accord would simplify the agreement and the procedures for situations involving the default of a Common Member. The New Accord additionally would minimize "double-margining" situations when a Common Member

¹⁸ Balance Order Securities are defined in NSCC Rule 1, and are generally securities, other than foreign securities, that are eligible to be cleared at NSCC but are not eligible for processing through the CNS Accounting Operation. See supra note 4.

¹⁹ OCC will continue to guarantee settlement until settlement actually occurs with respect to these Stock Options and Stock Futures.

may simultaneously owe margin to both NSCC and OCC with respect to the same E&A/Delivery Transaction.

Under the New Accord, after NSCC has received an E&A/Delivery Transaction, the Guaranty Substitution would normally occur when NSCC has received all Required Deposits to its Clearing Fund, calculated taking into account such E&A/Delivery Transaction, of Common Members (“Guaranty Substitution Time”).²⁰ At the Guaranty Substitution Time, NSCC’s Guaranty would take effect, and OCC would no longer retain any settlement obligations with respect to such E&A/Delivery Transactions.

The Guaranty Substitution would not occur, however, with respect to any E&A/Delivery Transaction if NSCC has rejected such E&A/Delivery Transaction due to an improper submission, as described above. The Guaranty Substitution also would not occur if, after NSCC’s receipt of the E&A/Delivery Transaction but prior to receiving corresponding Clearing Fund deposits, a Common Member involved in the E&A/Delivery Transaction has defaulted on its obligations to NSCC by failing to meet its Clearing Fund obligations, or NSCC has otherwise ceased to act for such Common Member pursuant to the NSCC Rules (in either case, such Common Member becomes a “Defaulting NSCC Member”).

NSCC would be required to promptly notify OCC if a Common Member becomes a Defaulting NSCC Member, as described above. Upon receiving such a notice, OCC would not submit to NSCC any additional E&A/Delivery Transactions involving the Defaulting NSCC Member for settlement, unless authorized representatives of both OCC

²⁰ Procedure XV of the NSCC Rules provides that all Clearing Fund requirements and other deposits be made within one hour of demand, unless NSCC determines otherwise. See supra note 4.

and NSCC otherwise consent. OCC would, however, deliver to NSCC a list of all E&A/Delivery Transactions that have already been submitted to NSCC and that involve the Defaulting NSCC Member (“Defaulted NSCC Member Transactions”). The Guaranty Substitution would not occur with respect to such Defaulted NSCC Member Transactions, unless both Clearing Agencies agree otherwise. Therefore, NSCC would have no obligation to guarantee such Defaulted NSCC Member Transactions, and OCC would continue to be responsible for effecting the settlement of such Defaulted NSCC Member Transactions pursuant to OCC’s By-Laws and Rules. Once NSCC has confirmed the list of Defaulted NSCC Member Transactions, Guaranty Substitution would occur for all submitted E&A/Delivery Transactions for that Activity Date that are not included on such list (i.e., those transactions not involving the Defaulting NSCC Clearing Member). NSCC would be required to promptly notify OCC upon the occurrence of the Guaranty Substitution Time on each Activity Date.

If OCC suspends a Common Member after NSCC has received the E&A/Delivery Transactions but before the Guaranty Substitution has occurred, and that Common Member has not become a Defaulting NSCC Member, the Guaranty Substitution would proceed at the Guaranty Substitution Time. In such a scenario, OCC would continue to be responsible for guaranteeing the settlement of the E&A/Delivery Transactions in question until the Guaranty Substitution Time, at which time the responsibility would transfer to NSCC. If, however, the suspended Common Member also becomes a Defaulting NSCC Member after NSCC has received the E&A/Delivery Transactions but before the Guaranty Substitution has occurred, Guaranty Substitution would not occur, and OCC would continue to be responsible for effecting the settlement of such Defaulted

NSCC Member Transactions pursuant to OCC's By-Laws and Rules (unless both Clearing Agencies agree otherwise).

Finally, the New Accord also would provide for the consistent treatment of all exercise and assignment activity under the agreement. Under the Existing Accord, "standard"²¹ option contracts become guaranteed by NSCC when the Common Member meets its morning Clearing Fund Required Deposit at NSCC while "non-standard" exercise and assignment activity becomes guaranteed by NSCC at midnight of the day after trade date (T+1). Under the New Accord, all exercise and assignment activity for Eligible Securities would be guaranteed by NSCC as of the Guaranty Substitution Time, under the circumstances described above, further simplifying the framework for the settlement of such contracts.

Other Terms of the New Accord

The New Accord would include a number of other provisions intended to maintain certain terms of the Existing Accord or improve the procedures, information sharing, and overall governance process under the new agreement. Many of these terms are additions to or improvements upon the terms of the Existing Accord.

Under the proposed New Accord, the Clearing Agencies would agree to address the specifics regarding the time, form, and manner of various required notifications and actions in a separate service level agreement, which the parties would be able to revisit as their operational needs evolve. The separate service level agreement also would specify an effective date for the New Accord, which would occur on a date following approval

²¹ Option contracts with "standard" expirations expire on the third Friday of the specified expiration month, while "non-standard" contracts expire on other days of the expiration month.

and effectiveness of all required regulatory submissions to be filed by OCC and NSCC with the appropriate regulatory authorities. Similar to the Existing Accord, the proposed New Accord would remain in effect: (a) until it is terminated by the mutual written agreement of OCC and NSCC; (b) until it is unilaterally terminated by either Clearing Agency upon one year's written notice (as opposed to six months under the Existing Accord); or (c) until it is terminated by either NSCC or OCC upon the bankruptcy or insolvency of the other, provided that the election to terminate is communicated to the other party within three business days by written notice.

Under the proposed New Accord, NSCC would agree to notify OCC if NSCC ceases to act for a Common Member pursuant to the NSCC Rules no later than the earlier of NSCC's provision of notice of such action to the governmental authorities or notice to other NSCC Members. Furthermore, if an NSCC Member for which NSCC has not yet ceased to act fails to satisfy its Clearing Fund obligations to NSCC, NSCC would be required to notify OCC promptly after discovery of the failure. Likewise, OCC would be required to notify NSCC of the suspension of a Common Member no later than the earlier of OCC's provision of notice to the governmental authorities or other OCC Clearing Members.

Under the Existing Accord, NSCC and OCC agree to share certain reports and information regarding settlement activity and obligations under the agreement. The New Accord would enhance this information sharing between the Clearing Agencies. For example, the Clearing Agencies would agree to share certain information, including general risk management due diligence regarding Common Members, lists of Common Members, and information regarding margin and settlement obligations of the Common

Members. The Clearing Agencies would also agree to provide each other with any other information that the other reasonably requests in connection with their obligations under the New Accord. All such information would be required to be kept confidential, using the same care and discretion that each Clearing Agency uses for the safekeeping of its own members' confidential information. NSCC and OCC would each be required to act in good faith to resolve and notify the other of any errors, discrepancies or delays in the information it provides.

The New Accord also would include new terms to provide that, to the extent a Clearing Agency is unable to perform any obligation as a result of the failure of the other Clearing Agency to perform its responsibilities on a timely basis, the time for the non-failing Clearing Agency's performance would be extended, its performance would be reduced to the extent of any such impairment, and it would not be liable for any failure to perform its obligations. Further, NSCC and OCC would agree that neither Clearing Agency would be liable to the other Clearing Agency in connection with its performance of its obligations under the proposed New Accord to the extent it has acted, or omitted or ceased to act, with the permission or at the direction of a governmental authority.

Moreover, the proposed New Accord would provide that in no case would either Clearing Agency be liable to the other for punitive, incidental or consequential damages. The purpose of these new provisions is to provide clear and specific terms regarding each Clearing Agency's liability for non-performance under the agreement.

The proposed New Accord would also contain the usual and customary representations and warranties for an agreement of this type, including representations as to the parties' good standing, corporate power and authority and operational capability,

that the agreement complies with laws and all government documents and does not violate any agreements, and that all of the required regulatory notifications and filings would be obtained prior to the New Accord's effective date. It would also include representations that the proposed New Accord constitutes a legal, valid and binding obligation on each of OCC and NSCC and is enforceable against each, subject to standard exceptions. Furthermore, the proposed New Accord would contain a force majeure provision, under which NSCC and OCC would agree to notify the other no later than two hours upon learning that a force majeure event has occurred and both parties would be required to cooperate in good faith to mitigate the effects of any resulting inability to perform or delay in performing.

Proposed Amendments to NSCC Rules

Given the key differences between the Existing Accord and the New Accord, as described above, NSCC proposes certain changes to Procedures III and XV of the NSCC Rules to accommodate the terms of the New Accord. In particular, NSCC would update Section B of Procedure III to define the scope of the New Accord. First, the proposed Section B of Procedure III would identify the E&A/Delivery Transactions, and would make clear that the New Accord would apply only to E&A/Delivery Transactions that are in either CNS Securities or Balance Order Securities, as such terms are defined in the NSCC Rules. The proposed Section B of Procedure III would also define the Common Members, or firms that must be named as counterparties to E&A/Delivery Transactions, as "Participating Members." The proposal would describe the Guaranty Substitution Time and would describe the circumstances under which the Guaranty Substitution would not occur. Finally, the proposed Section B of Procedure III would describe how

E&A/Delivery Transactions for which the Guaranty Substitution has occurred would be processed at NSCC both if they are covered by the proposed New Accord and if they are not covered by the proposed New Accord because, for example, they are not transactions in CNS Securities or Balance Order Securities or were not submitted for regular way settlement.

Finally, NSCC is also proposing to amend Procedure XV to remove reference to the exclusion of E&A/Delivery Transactions from the calculation of the mark-to-market margin component of its Clearing Fund calculations, which is no longer applicable under the proposed New Accord where the Guaranty Substitution would replace the transfer of a defaulting Common Member's margin payments under the Existing Accord. Therefore, NSCC is not proposing any change to its margining methodology, but will include E&A/Delivery Transactions in the calculation of the mark-to-market margin component of Common Members' Clearing Fund Required Deposits following implementation of the New Accord.

Proposed Amendments to OCC's By-Laws and Rules

OCC also proposes certain changes to its By-Laws and Rules to accommodate the terms of the New Accord. The primary purpose of the proposed changes is to: (1) reflect the expanded scope of the New Accord, (2) reflect changes related to the new Guaranty Substitution mechanics of the New Accord; and (3) make other changes necessary to conform to the terms of the New Accord or to otherwise provide additional clarity around the settlement and margining²² treatment of: (i) Eligible Securities under the New

²² OCC notes that, while it is proposing changes to its Rules concerning margin requirements (e.g., which transactions would be included as part of OCC's margin calculation at a given point in time), OCC is not proposing any changes to its

Accord, (ii) non-regular way securities settling through the facilities of NSCC but outside of the New Accord, and (iii) those securities settling outside of the New Accord and away from NSCC on a broker-to-broker basis. These proposed changes are discussed in greater detail below.

Changes Related to the Expanded Scope of the New Accord

First, OCC proposes to amend and replace the defined term “CNS-eligible”²³ to reflect the expanded definition of Eligible Securities under the New Accord. The term “CNS-eligible” currently describes the securities underlying the physically-settled stock options that are eligible under the Existing Accord to be settled through NSCC’s CNS Accounting Operation. Under the New Accord, however, the term Eligible Securities is more broadly defined to include securities (both Stock Options and Stock Futures) eligible for settlement via NSCC’s CNS Accounting Operation and NSCC’s Balance Order Accounting Operation. Accordingly, OCC proposes to use “CCC,” for “correspondent clearing corporation”²⁴ to describe the Eligible Securities. Thus, the term “CCC-eligible” would replace “CNS-eligible” throughout OCC’s By-Laws and Rules.

Next, because the New Accord would include the settlement of securities underlying Stock Futures, OCC proposes to make several changes to its rules regarding

margin model (with the exception that OCC would no longer collect and hold margin for positions after NSCC’s Guaranty has taken effect under the New Accord).

²³ See Article I, Section (C)(23) of OCC’s By-Laws.

²⁴ Under Article I of OCC’s By-Laws, the term "correspondent clearing corporation" means the National Securities Clearing Corporation or any successor thereto which, by agreement with the Corporation, provides facilities for settlements in respect of exercised option contracts or BOUNDS (i.e., securities issued by OCC pursuant to Article XXIV of OCC’s By-Laws and Chapter XXV of OCC’s Rules) or in respect of delivery obligations arising from physically-settled stock futures. See supra note 4.

Stock Futures to accommodate this expansion. More specifically, OCC proposes a conforming amendment to Rule 901 Interpretation and Policy (.02) to clarify that, under the New Accord, OCC will, subject to its discretion, cause the settlement of all matured Stock Futures to be made through the facilities of NSCC to the extent that the underlying securities are CCC-eligible as the term is currently proposed.

OCC also proposes clarifying and conforming revisions to newly renumbered Rule 901(e) (currently Rule 901(d)) to specify that settlements made through the facilities of the correspondent clearing corporation are governed by Rule 901 and to clarify that, under the New Accord, specifications made in any Delivery Advice may be revoked up until the point at which NSCC's Guaranty has taken effect (the "obligation time" as discussed below) and not the opening of business on the delivery date.

Changes Related to Guaranty Substitution

OCC also proposes a series of amendments to its Rules to accurately reflect the process under which the Guaranty Substitution occurs under the New Accord. First, OCC proposes to amend Rule 901(c) so that the term "obligation time" -- the time that the correspondent clearing corporation becomes unconditionally obligated, in accordance with its rules, to effect settlement in respect thereof or to close out the securities contract arising therefrom -- is synonymous with the Guaranty Substitution Time under the New Accord (i.e., (i) settlement obligations are reported to and are not rejected by NSCC; (ii) NSCC has not notified OCC that NSCC has ceased to act for the relevant Clearing Member; and (iii) the Clearing Fund requirements of the relevant Clearing Member are received by NSCC). Under the New Accord, if a default occurs prior to the Guaranty Substitution Time, the Guaranty Substitution will not occur for any E&A/Delivery

Transactions involving the Defaulting NSCC Member, and OCC will continue to guarantee settlement for those Defaulted NSCC Member Transactions.

Next, OCC proposes to amend language in newly renumbered Rule 901(i) (currently Rule 901(h)) regarding the timing of the end of a Clearing Member's obligations to OCC with respect to securities to be settled through NSCC. Under the Existing Accord and OCC's existing Rules, a Clearing Member's obligations to OCC end only once settlement is completed. Under the New Accord, however, a Clearing Member's obligations to OCC will end when OCC's obligations with respect to guaranteeing settlement of the security would end (*i.e.*, the Guaranty Substitution Time or "obligation time"). OCC therefore proposes to amend newly renumbered Rule 901(i) to specify that a Clearing Member's obligations to OCC will be deemed completed and performed once the "obligation time" has occurred.

As discussed above, the New Accord eliminates the provisions of the Existing Accord whereby OCC and NSCC guaranteed each other the performance of Common Members and made certain payments to the other upon the default of a Common Member. Therefore, OCC proposes to delete discussions of such guarantees and payments from newly renumbered Rule 901(i) and Rule 1107.

OCC also proposes amendments to Rules 910 and 911, which set forth procedures for handling failures to make or take delivery of securities in settlement of exercised or assigned Stock Options and matured physically-settled Stock Futures, to add language to both rules to clarify that the failure procedures set forth therein would not apply with respect to any delivery to be made through NSCC pursuant to Rule 901. Under the New Accord, once the Guaranty Substitution Time with respect to a specific E&A/Delivery

Transaction occurs, OCC's Guaranty ends and NSCC's Guaranty begins, leaving OCC with no involvement with or responsibility for the settlement of the securities underlying that transaction. Therefore, if there is a failure to make or take delivery with respect to that transaction after Guaranty Substitution has occurred, the NSCC Rules will govern that failure. With respect to deliveries made on a broker-to-broker basis under OCC Rules 903 through 912 (including those that may utilize NSCC's Obligation Warehouse services), and which are not governed by Rule 901, Guaranty Substitution does not occur and OCC's failure procedures would apply.

Changes to OCC's Margin Rules

Under the New Accord, OCC will no longer collect margin on a transaction once it is no longer guaranteeing settlement for that transaction. Therefore, OCC proposes to add language to Rule 601(f) to clarify that OCC's margin calculations will not include delivery obligations arising from any Stock Options or Stock Futures that are eligible for settlement through NSCC and for which OCC has no further settlement obligations because either (i) Guaranty Substitution has occurred for E&A/Delivery Transactions under the New Accord (as described in revised Rule 901(c)) or (ii) NSCC has otherwise accepted transactions for non-regular way settlement under the NSCC Rules (as describe in newly proposed Rule 901(d)).²⁵ By not including these transactions as part of OCC's margin calculation, OCC is hoping to alleviate instances of "double-margining" for Common Members that may otherwise simultaneously owe margin to NSCC and OCC with respect to the same position.

OCC also proposes to delete Rule 608A in its entirety. The New Accord seeks to

²⁵ Related revisions to Rule 901(c) and newly proposed Rule 901(d) are discussed in more detail below.

eliminate the situation under the Existing Accord where Common Members are effectively “double-margined” or required to simultaneously post margin with OCC and NSCC with respect to the same position. As the New Accord eliminates this double-margining scenario, Rule 608A, which provides procedures pursuant to which a Clearing Member could use the securities deposited as margin with OCC as collateral to secure a loan to pay its margin obligations to NSCC, is now unnecessary.

Other Clarifying Changes Not Related to the New Accord

OCC also proposes to amend its Rules to make clarifying changes that are not directly required by the New Accord but would provide additional clarity in its Rules in light of other changes being made to accommodate the New Accord. Specifically, OCC proposes to revise Rule 901 Interpretation and Policy (.02) to provide that transactions that involve the delivery of non-CCC eligible securities made on a broker-to-broker basis (and away from NSCC) may nevertheless involve the use of certain services of NSCC (e.g., NSCC’s Obligation Warehouse). For such transactions, because they are not covered by the New Accord and NSCC at no point guarantees settlement, OCC Rule 901 would not apply and delivery is governed by the broker-to-broker settlement procedures set forth in OCC Rules 903 through 912, as is the case currently today. Additionally, while OCC’s existing Rules do not prohibit broker-to-broker settlements from being facilitated through the services of a correspondent clearing corporation, they do not explicitly contemplate the possibility. OCC also proposes to make clarifying amendments to Rule 904(b) and 910A(a) to more clearly distinguish between settlements effected through NSCC’s CNS Accounting Operation or Balance Order Accounting Operations in accordance with OCC Rule 901 and deliveries effected on a broker-to-

broker basis utilizing services of NSCC under OCC Rules 903 through 912 and to clearly state which OCC Rules apply in each context.

Further, OCC proposes to add a new paragraph (d) to Rule 901 to clarify that OCC still intends, at its discretion, to effect settlement of Stock Options and Stock Futures that are scheduled to be settled on the first business day after exercise or maturity through NSCC pursuant to Rule 901 and the relevant provisions of the NSCC Rules, even though such contracts are outside the scope of the New Accord. These contracts would continue to be settled as they are currently today.

OCC also proposes clarifying and conforming changes to the introductory language of Chapter IX of the Rules. Specifically, OCC proposes conforming changes to the Rule to reflect the replacement of the defined term “CNS-eligible” with “CCC-eligible” as described above. The proposed changes would also clarify that OCC’s broker-to-broker settlement rules are contained in Rules 903-912, as Rule 902 concerns Delivery Advices, which also may be applicable to settlements made through the correspondent clearing corporation pursuant to Rule 901. In addition, the proposed changes to the introductory language of Chapter IX of the Rules would provide additional clarity around OCC’s existing authority to alter a previous designation of a settlement method at any time prior to the designated delivery date by specifying that this authority would apply to both settlements to be made through the facilities of the correspondent clearing corporation pursuant to Rule 901 or settlements to be made on a broker-to-broker basis pursuant to Rules 903 through 912. Finally, OCC proposes a number of conforming changes to Rules 901 and 912 to reflect the renumbering of various Rule provisions due to the proposed amendments described above.

II. Discussion and Commission Findings

Although the Clearing Supervision Act does not specify a standard of review for an advance notice, its stated purpose is instructive: to mitigate systemic risk in the financial system and promote financial stability by, among other things, promoting uniform risk management standards for systemically important financial market utilities and strengthening the liquidity of systemically important financial market utilities.²⁶

Section 805(a)(2) of the Clearing Supervision Act²⁷ authorizes the Commission to prescribe risk management standards for the payment, clearing and settlement activities of designated clearing entities engaged in designated activities for which the Commission is the supervisory agency. Section 805(b) of the Clearing Supervision Act²⁸ provides the following objectives and principles for the Commission's risk management standards prescribed under Section 805(a):

- to promote robust risk management;
- to promote safety and soundness;
- to reduce systemic risks; and
- to support the stability of the broader financial system.

The Commission has adopted risk management standards under Section 805(a)(2) of the Clearing Supervision Act²⁹ and Section 17A of the Act (“Rule 17Ad-22”).³⁰ Rule

²⁶ 12 U.S.C. 5461(b).

²⁷ 12 U.S.C. 5464(a)(2).

²⁸ 12 U.S.C. 5464(b).

²⁹ 12 U.S.C. 5464(a)(2).

³⁰ See 17 CFR 240.17Ad-22.

17Ad-22 requires registered clearing agencies to establish, implement, maintain, and enforce written policies and procedures that are reasonably designed to meet certain minimum requirements for their operations and risk management practices on an ongoing basis.³¹ Therefore, it is appropriate for the Commission to review proposed changes in advance notices against the objectives and principles of these risk management standards as described in Section 805(b) of the Clearing Supervision Act and against Rule 17Ad-22.³²

A. Consistency with Section 805(b) of the Clearing Supervision Act

The Commission believes that the changes proposed in the Advance Notices are consistent with Section 805(b) of the Clearing Supervision Act³³ because they are designed to reduce systemic risk and to promote robust risk management by mitigating operational risk.

The proposal would expand the category of securities eligible for settlement and guarantee under the New Accord to include Stock Futures deliveries that are eligible to settle through NSCC's CNS Accounting Operation, as well as securities underlying Stock Options and Stock Futures that are eligible to settle through NSCC's Balance Order Accounting Operation, where each are scheduled to settle regular way. By including these additional securities as part of the New Accord, the proposal would provide for more uniform settlement processing of securities with regular way settlement. According to the Clearing Agencies, the expansion of the category of securities eligible for

³¹ Id.

³² 12 U.S.C. 5464(b).

³³ Id.

settlement and guarantee under the New Accord would simplify the settlement process for these additional securities transactions. By providing for more uniform settlement processing, simplifying the settlement process, and subjecting such transactions to enhanced information sharing and governance, as described below, this change is intended to promote robust risk management by mitigating operational risk.

The proposal would establish additional arrangements concerning the procedures, information sharing, and overall governance processes under the New Accord. For example, the Clearing Agencies would agree to share certain information, including general risk management due diligence regarding Common Members, lists of Common Members, and information regarding margin and settlement obligations of the Common Members. The Clearing Agencies also would agree to provide each other with any other information that the other reasonably requests in connection with their obligations under the New Accord. Such agreements are designed to help the Clearing Agencies to more effectively identify, monitor, and manage risks that may be presented by certain Common Members.

The New Accord also would establish the Guaranty Substitution Time (i.e., a specific point in time where trade guarantee obligations would transfer from OCC to NSCC), with respect to the applicable securities transactions, as described above. The Guaranty Substitution Time would help eliminate ambiguity and complexity that exists in the current guarantee practice regarding which Clearing Agency is responsible for guaranteeing settlement at any given moment, and help provide greater certainty that, in the event of the default of a Common Member, the default would be handled pursuant to the rules and procedures of the Clearing Agency whose guarantee is then in effect. This

proposed change is designed to help strengthen the Clearing Agencies' abilities to plan for, manage, and, therefore, mitigate the risks that the default of a Common Member could present to the Clearing Agencies, other clearing members, and the market as a whole.

By assisting the Clearing Agencies with mitigating operational risk, as well as more effectively managing risks presented by certain Common Members, including the risk presented by Common Member defaults, the proposed changes are designed to reduce systemic risk and promote robust risk management. Therefore, the Commission believes that the changes proposed in the Advance Notices are consistent with Section 805(b) of the Clearing Supervision Act.³⁴

B. Consistency with Rule 17Ad-22(e)(20)

The Commission believes that the changes proposed in the Advance Notices are consistent with Rule 17Ad-22(e)(20) under the Act, which requires, in part, that the Clearing Agencies establish, implement, maintain and enforce written policies and procedures reasonably designed to identify, monitor, and manage risks related to any link the clearing agency establishes with one or more other clearing agencies.³⁵

Under the terms of the Existing Accord, even after NSCC's trade guarantee has taken effect, OCC is not released from its trade guarantee with respect to the transactions until certain deadlines have passed, as discussed above. As a result, the Existing Accord creates a complicated framework for the settlement of securities underlying certain Stock

³⁴ Id.

³⁵ 17 CFR 240.17Ad-22(e)(20).

Options, which could lead to an unanticipated disruption to the Clearing Agencies' respective clearing operations.

The New Accord is designed to better mitigate and manage the risks related to the link the Clearing Agencies have established with each other to settle the securities underlying Stock Options and Stock Futures. For example, by instituting the Guaranty Substitution Time, the New Accord would provide for a clearer, simpler framework for the settlement of securities underlying certain Stock Options and Stock Futures by setting a specific time at which trade guarantee obligations would transfer from OCC to NSCC. This would help eliminate the ambiguity that currently exists regarding which Clearing Agency is responsible for guaranteeing settlement at any given moment. It would also provide greater certainty that in the event of a Common Member default, the default would be handled pursuant to the rules and procedures of the Clearing Agency whose guarantee is then in effect. This greater certainty, in turn, is designed to help improve the OCC's and NSCC's ability to plan for and manage the risk presented by the default of a Common Member, and the effects that such a default could have on other members and the markets the Clearing Agencies serve.

In connection with the proposal to put additional arrangements into place concerning the procedures, information sharing, and overall governance processes under the New Accord, the Clearing Agencies would agree to share certain information, including general surveillance information regarding their members. Such arrangements are designed to help each Clearing Agency more effectively identify, monitor, and manage risks that may be presented by Common Members.

For the above reasons, the Commission believes that the New Accord is designed to assist the Clearing Agencies in identifying, monitoring, and managing risks related to the link between the Clearing Agencies. Therefore, the Commission believes that the changes proposed in the Advance Notices are consistent with Rule 17Ad-22(e)(20).³⁶

C. Consistency with Rule 17Ad-22(e)(21)

The Commission believes that the proposal is consistent with Rule 17Ad-22(e)(21) under the Act, which requires, in part, that the Clearing Agencies establish, implement, maintain and enforce written policies and procedures reasonably designed to be efficient and effective in meeting the requirements of its participants and the markets it serves.³⁷ As described above, the proposal would modify the timing of the Guaranty Substitution by establishing the Guaranty Substitution Time. In doing so, the New Accord would minimize the “double margining” issue³⁸ that is present under the Existing Accord. As a result, Common Members would no longer be required to post margin at both Clearing Agencies to cover the same transactions. By simplifying the terms of the existing agreement in this way, the New Accord is designed to be more efficient and

³⁶ Id.

³⁷ 17 CFR 240.17Ad-22(e)(21).

³⁸ As noted above, under the Existing Accord, even after NSCC’s trade guarantee has taken effect, OCC retains its trade guarantee obligations with respect to the options exercise or assignment until certain deadlines have passed on the first business day following the scheduled settlement date. Once such deadlines have passed, OCC is released from its trade guarantee unless NSCC has notified OCC that the relevant Common Member has failed to meet an obligation to NSCC or NSCC has ceased to act for such firm. This results in a period of time during which NSCC’s trade guarantee overlaps with OCC’s trade guarantee, for which both Clearing Agencies collect and hold margin from the Common Member. See supra note 15.

effective in meeting the requirements of OCC's and NSCC's participants and the markets they serve.

Furthermore, as described above, the proposed changes would establish additional arrangements between the Clearing Agencies concerning the procedures, information sharing, and overall governance processes under the New Accord. Such arrangements could enhance information sharing between the Clearing Agencies and enable them to more effectively identify, monitor, and manage risks that may be presented by certain Common Members.

Because the New Accord would allow for greater information sharing and eliminate the need for Common Members to post margin at both Clearing Agencies for the same transactions, the Commission believes the proposal is designed to be efficient and effective in meeting the requirements of Common Members. Therefore, the Commission believes that the changes proposed in the Advance Notices are consistent with the requirements of Rule 17Ad-22(e)(21).³⁹

³⁹ 17 CFR 240.17Ad-22(e)(21).

III. Conclusion

IT IS THEREFORE NOTICED, pursuant to Section 806(e)(1)(I) of the Clearing Supervision Act,⁴⁰ that the Commission DOES NOT OBJECT to these advance notice proposals (SR-NSCC-2017-803 and SR-OCC-2017-804) and that the Clearing Agencies are AUTHORIZED to implement the proposals as of the date of this notice or the date of an order by the Commission approving a proposed rule change that reflects rule changes that are consistent with the relevant advance notice proposal (SR-NSCC-2017-007, SR-OCC-2017-013), whichever is later.

By the Commission.

Eduardo A. Aleman
Assistant Secretary

⁴⁰ 12 U.S.C. 5465(e)(1)(I).