

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-81040; File No. SR-OCC-2017-804)

June 28, 2017

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of Advance Notice Concerning the Adoption of a New Stock Options and Futures Settlement Agreement Between The Options Clearing Corporation and the National Securities Clearing Corporation

Pursuant to Section 806(e)(1) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, entitled Payment, Clearing and Settlement Supervision Act of 2010 (“Clearing Supervision Act” or “Payment, Clearing and Settlement Supervision Act”)<sup>1</sup> and Rule 19b-4(n)(1)(i) of the Securities Exchange Act of 1934 (“Act”),<sup>2</sup> notice is hereby given that on June 1, 2017, The Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission (“Commission”) an advance notice as described in Items I, II and III 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 in connection with proposed changes relating to a new Stock Options and Futures Settlement Agreement (“New Accord”) between OCC and the National Securities Clearing Corporation (“NSCC,” collectively NSCC and OCC may be referred to herein as the “clearing agencies”) and amendments to OCC’s By-Laws and Rules to accommodate the proposed provisions of the New Accord.

The proposed changes to OCC’s By-Laws and Rules and the proposed New

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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).

Accord were submitted as Exhibits 5A - 5C of the filing, respectively.<sup>3</sup> The proposed changes are described in detail in Item 10 below. All terms with initial capitalization not defined herein have the same meaning as set forth in OCC's By-Laws and Rules.<sup>4</sup>

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.

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

Written comments were not and are not intended to be solicited with respect to the proposed rule change and none have been received. OCC will notify the Commission of any written comments received by OCC.

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

**Description of the Proposed Change**

**Background**

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<sup>3</sup> OCC has filed a proposed rule change with the Commission in connection with the New Accord. See SR-OCC-2017-013. NSCC also has filed proposed rule change and advance notice filings with the Commission in connection with the New Accord. See NSCC filings SR-NSCC-2017-007 and SR-NSCC-2017-803, respectively.

<sup>4</sup> OCC's By-Laws and Rules can be found on OCC's public website: <http://optionsclearing.com/about/publications/bylaws.jsp>. Other terms not defined herein or in the OCC By-Laws and Rules can be found in the Rules & Procedures of NSCC ("NSCC Rules"), available at [http://www.dtcc.com/~media/Files/Downloads/legal/rules/nsccl\\_rules.pdf](http://www.dtcc.com/~media/Files/Downloads/legal/rules/nsccl_rules.pdf), as the context implies.

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 OCC. OCC and NSCC are parties to a Third Amended and Restated Options Exercise Settlement Agreement, dated February 16, 1995, as amended ("Existing Accord"),<sup>5</sup> which governs the delivery and receipt of stock in the settlement of put and call options issued by OCC ("Stock Options") that are eligible for settlement through NSCC's Continuous Net Settlement ("CNS") Accounting Operation and are designated to settle on the third business day following the date the related exercise or assignment was accepted by NSCC ("Options E&A"). All OCC Clearing Members that intend to engage in Stock Options transactions are required to also be Members of NSCC or to have appointed or nominated an NSCC Member to act on its behalf.<sup>6</sup>

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<sup>5</sup> The Existing Accord and the proposed changes thereunder were previously approved by the Commission. See Securities Exchange Act Release No. 37731 (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).

<sup>6</sup> 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

OCC proposes to adopt a New Accord with NSCC, which would provide for the settlement of certain Stock Options and delivery obligations arising from certain matured physically-settled stock futures contracts cleared by OCC (“Stock Futures”). Specifically, the New Accord would, among other things: (1) expand the category of securities that are 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 (in addition to its CNS 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; (2) 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 (such transfer being the “Guaranty Substitution”); and (3) put additional arrangements into place concerning the procedures, information sharing, and overall governance processes under the agreement. Furthermore, OCC proposes to make certain clarifying and conforming changes to the OCC By-Laws and Rules as necessary to implement the New Accord.

The primary purpose of the proposed changes is to (1) provide consistent treatment across all expiries for products with “regular way”<sup>7</sup> settlement cycle

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is referred to herein as a “Common Member.”

<sup>7</sup> Under the New Accord, “regular way settlement” shall have a meaning agreed to by the clearing agencies. Generally, regular way settlement is understood to be

specifications; (2) reduce the operational complexities of the Existing Accord by eliminating the cross-guaranty between OCC and NSCC and the bifurcated risk management of exercised and assigned transactions between the two clearing agencies by delineating a single point in time at which OCC's Guaranty ceases and NSCC's Guaranty begins; (3) further solidify the roles and responsibilities of OCC and NSCC in the event of a default of a Common Member at either or both clearing agencies; and (4) 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 NSCC and OCC.<sup>8</sup>

### **The Existing Accord**

#### *Key Terms of the Existing Accord*

Under the Existing Accord, the settlement of Options E&A generally proceeds according to the following sequence of events. NSCC maintains and delivers to OCC a list ("CNS Eligibility Master File") that enumerates all CNS Securities, which are defined in NSCC's Rule 1 and generally include securities that have been designated by NSCC as

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the financial services industry's standard settlement cycle. Currently, regular way settlement of Stock Options or Stock Futures transactions are those transactions designated to settle on the third business day following the date the related exercise, assignment or delivery obligation was accepted by NSCC. NSCC has proposed to change the NSCC Rules with respect to the meaning of regular way settlement in order to be consistent with the anticipated industry-wide move to a shorter standard settlement cycle of two business days after trade date. See Securities Exchange Act Release No. 79734 (January 4, 2017), 82 FR 3030 (January 10, 2017) (SR-NSCC-2016-007). See also Securities Exchange Act Release No. 78962 (September 28, 2016), 81 FR 69240 (October 5, 2016) (S7-22-16) (Amendment to Securities Transaction Settlement Cycle).

<sup>8</sup> 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 this advance notice filing. See supra note 3.

eligible for processing through NSCC's CNS Accounting Operation and eligible for book entry delivery at NSCC's affiliate, The Depository Trust Company (for purposes of this advance notice filing, such securities are referred to as "CNS Eligible Securities").<sup>9</sup> 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,<sup>10</sup> listing the specific securities that are to be delivered and received in settlement of an Options E&A that have not previously been reported to NSCC and for which settlement is to be made through NSCC ("OCC Transactions File").<sup>11</sup> 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 reject a transaction if the security to be delivered has not been listed as a CNS Eligible Security in the CNS Eligible Master File or if information provided in the OCC

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<sup>9</sup> See supra note 4.

<sup>10</sup> 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. In theory, however, an Options E&A could, due to an error or delay, be reported later than the date of the option's exercise or expiration.

<sup>11</sup> 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.

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 Options E&A.

Under the Existing Accord, even after NSCC's trade guarantee has come into effect,<sup>12</sup> OCC is not released from its guarantee with respect to the Options E&A until certain deadlines<sup>13</sup> have passed on the first business day following the scheduled settlement date without NSCC notifying 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.<sup>14</sup> As a result, there is a period of time when NSCC's trade guarantee overlaps with OCC's guarantee and where both clearing agencies are holding margin against the same Options E&A position.

In the event that NSCC or OCC ceases to act on behalf of or suspends a Common Member, that Common Member becomes a "defaulting member." Once a Common Member becomes a defaulting member, the Existing Accord provides that NSCC will make a payment to OCC equal to the lesser of OCC's loss or the positive mark-to-market

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<sup>12</sup> 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 submission, 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.

<sup>13</sup> 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 it has ceased to act.

<sup>14</sup> See NSCC Rule 46 (Rule 46 (Restrictions on Access to Services)). See supra note 4.

amount relating to the defaulting member's Options E&A and that OCC will make a payment to NSCC equal to the lesser of NSCC's loss or the negative mark-to-market amount relating to the defaulting member's Options E&A to compensate for potential losses incurred in connection with the default. 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, NSCC proposes to adopt a New Accord with OCC, which would provide for the settlement of certain Stock Options and Stock Futures transactions. 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 transfer of guarantee obligations); 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) to be 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 Transactions<sup>15</sup> 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 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.

Like the Existing Accord, the proposed New Accord would continue to facilitate the processes by which Common Members deliver and receive stock in the settlement of Stock Options that are eligible to settle through NSCC's CNS Accounting Operation and

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<sup>15</sup> "E&A/Delivery Transactions" are transactions involving the settlement of 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.

are designated to settle regular way. The New Accord would also expand the category of securities eligible for settlement under the agreement. In particular, the New Accord would facilitate the processes by which Common Members deliver and receive stock in settlement of Stock Futures that are eligible to settle through NSCC's CNS Accounting Operation and are designated to settle regular way. It would also provide for the settlement of 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 that are neither CNS Securities nor Balance Order Securities.<sup>16</sup> 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.<sup>17</sup>

#### Proposed Changes Related to Guaranty Substitution

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<sup>16</sup> 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.

<sup>17</sup> OCC will continue to guarantee settlement until settlement actually occurs with respect to these Stock Options and Stock Futures.

The New Accord would adopt a fundamentally different approach to the delineation of the rights and responsibilities of OCC and NSCC with respect to E&A/Delivery Transactions. The purpose of the proposed changes related to the Guaranty Substitution, defined below, is to reduce the operational complexities of the Existing Accord by eliminating the cross-guaranty between OCC and NSCC and the bifurcated risk management of exercised and assigned transactions between the two clearing agencies and delineating a single point in time at which OCC's Guaranty ceases and NSCC's Guaranty begins. Moreover, the proposed changes would solidify the roles and responsibilities of OCC and NSCC in the event of a default of a Common Member at either or both clearing agencies.

As described above, the Existing Accord provides that NSCC will make a payment to OCC following the default of a Common Member in an amount equal to the lesser of OCC's loss or the positive mark-to-market amount relating to the Common Member's Options E&A, and provides that OCC will make a payment to NSCC following the default of a Common Member equal to the lesser of NSCC's loss or the negative mark-to-market amount relating to the Common Member's Options E&A to compensate for potential losses incurred in connection with the Common Member's default. The proposed New Accord, in contrast, would focus on the transfer of responsibilities from OCC to NSCC and, specifically, the point at which OCC's Guaranty ends and NSCC's Guaranty begins (i.e., the Guaranty Substitution) 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 may simultaneously owe margin to both NSCC and OCC with respect to the same E&A/Delivery Transaction.

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”).<sup>18</sup> At the Guaranty Substitution Time, NSCC’s Guaranty takes effect, and OCC does not 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, or if, during the time after NSCC’s receipt of the E&A/Delivery Transaction but prior to the Guaranty Substitution Time, 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 further E&A/Delivery Transactions involving the Defaulting NSCC Member for settlement, unless authorized representatives of both OCC

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<sup>18</sup> Procedure XV of the NSCC Rules provides that all Clearing Fund requirements and other deposits must 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 ordinarily would not occur with respect to any Defaulted NSCC Member Transactions, unless both clearing agencies agree otherwise. As such, NSCC would have no obligation to guaranty 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 E&A/Delivery Transactions for that Activity Date that are not included on such list. 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”<sup>19</sup> 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 also would include a number of other provisions intended to either generally 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, OCC and NSCC 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 service level agreement would also specify an effective date for the New Accord, which, as mentioned above, would occur on a date following approval and effectiveness of all required regulatory submissions to be filed by

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<sup>19</sup> 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.

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. Specifically, NSCC and OCC would agree to share certain information, including general risk management due diligence regarding Common Members, lists of Common Members, and information regarding the amounts of Common Members' margin and settlement obligations at OCC or Clearing Fund Required Deposits at NSCC. NSCC and OCC

would also be required to provide the other clearing agency with any other information that the other reasonably requests in connection with the performance of its 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 one party is unable to perform any obligation as a result of the failure of the other party to perform its responsibilities on a timely basis, the time for the non-failing party'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 party would be liable to the other party 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 OCC's By-Laws and Rules**

Given the key differences between the Existing Accord and the New Accord, as described above, OCC proposes certain changes to its By-Laws and Rules in order 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 margining<sup>20</sup> treatment of: (i) Eligible Securities under the New Accord, (ii) non-regular way securities settling through the facilities of NSCC but outside of the New Accord, and (iii) those securities settling

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<sup>20</sup> 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 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).

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”<sup>21</sup> in order 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”<sup>22</sup> 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 Stock Futures, OCC proposes to make several changes to its rules regarding 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.

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<sup>21</sup> See Article I, Section (C)(23) of OCC’s By-Laws.

<sup>22</sup> 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 or in respect of delivery obligations arising from physically-settled stock futures.

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 and (i.e., (i) settlement obligations are reported to and are not rejected by NSCC; (ii) NSCC has not notified OCC that it 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. As such, 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. As such, 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)).<sup>23</sup> 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 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

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<sup>23</sup> Related revisions to Rule 901(c) and newly proposed Rule 901(d) are discussed in more detail below.

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.

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

OCC believes that the proposed change, which would adopt the New Accord and make conforming changes to the OCC By-Laws and Rules to accommodate the New Accord, would reduce the overall level of risk to OCC, its Clearing Members, and the markets served by OCC.

In connection with the proposal to enhance the timing of the Guaranty Substitution, the New Accord would provide a clearer, simpler framework for the settlement of Stock Options and Stock Futures. By pinpointing a specific moment in time, the Guaranty Substitution Time, at which guarantee obligations transfer from OCC to NSCC with respect to each cleared securities transaction, the New Accord would eliminate any ambiguity regarding which clearing agency is responsible for guaranteeing settlement at any given moment. Establishing a precise Guaranty Substitution Time also provides 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 and the system for the settlement and clearance of Stock Options and Stock Futures would continue with minimal interruption. This greater certainty strengthens OCC's and NSCC's ability to plan for and manage, and therefore mitigate, the risk presented by Common Member defaults to OCC, other Clearing Members and the market as a whole.

The proposal to expand the category of securities eligible for settlement and guaranty under the New Accord would provide consistent treatment across all expiries for products with regular way settlement cycle specifications, and would provide a clearer, simpler framework for the settlement of these securities. Finally, the proposal to put additional arrangements into place concerning the procedures, information sharing, and overall governance processes under the New Accord, would assist the clearing agencies to more effectively identify, monitor, and manage risks that may be presented by certain Common Members, and would create new efficiencies in their general surveillance efforts with respect to these firms.

## **Consistency with the Clearing Supervision Act**

The stated purpose of the Clearing Supervision Act is 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.<sup>24</sup>

Section 805(a)(2) of the Clearing Supervision Act<sup>25</sup> also authorizes the Commission to prescribe risk management standards for the payment, clearing and settlement activities of designated clearing entities, like OCC, for which the Commission is the supervisory agency. Section 805(b) of the Clearing Supervision Act<sup>26</sup> states that the objectives and principles for risk management standards prescribed under Section 805(a) shall be to:

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

The Commission has adopted risk management standards under Section 805(a)(2) of the Clearing Supervision Act and the Act in furtherance of these objectives and principles, including those standards adopted pursuant to the Commission rules cited

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<sup>24</sup> 12 U.S.C. 5461(b).

<sup>25</sup> 12 U.S.C. 5464(a)(2).

<sup>26</sup> 12 U.S.C. 5464(b).

below.<sup>27</sup> For the reasons set forth below, OCC believes that the proposed change is consistent with the risk management standards promulgated under Section 805(a) of the Clearing Supervision Act.<sup>28</sup>

Rule 17Ad-22(e)(1) requires that a covered clearing agency establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for a well-founded, clear, transparent, and enforceable legal basis for each aspect of its activities in all relevant jurisdictions.<sup>29</sup> The New Accord would constitute a legal, valid and binding obligation on each of OCC and NSCC, which is enforceable against each clearing agency. In connection with the proposal to enhance the timing of the Guaranty Substitution, the New Accord would establish clear, transparent, and enforceable terms for the settlement of OCC's cleared Stock Options and Stock Futures through the facilities of NSCC and would simplify the settlement process for those Stock Options currently settled under the Existing Accord. By clarifying the timing and mechanisms by which OCC's Guaranty ends and NSCC's Guaranty begins by focusing on the timing of the Guaranty Substitution, the new Accord, specifically the proposal to enhance the timing of the Guaranty Substitution, would provide a clear, transparent and enforceable legal basis for OCC's and NSCC's obligations during the event of a Common Member default. As a result, OCC believes that the proposal is consistent with the requirements

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<sup>27</sup> 17 CFR 240.17Ad-22. See Securities Exchange Act Release Nos. 68080 (October 22, 2012), 77 FR 66220 (November 2, 2012) (S7-08-11) ("Clearing Agency Standards"); 78961 (September 28, 2016), 81 FR 70786 (October 13, 2016) (S7-03-14) ("Standards for Covered Clearing Agencies"). The Standards for Covered Clearing Agencies became effective on December 12, 2016. OCC is a "covered clearing agency" as defined in Rule 17Ad-22(a)(5) and therefore is subject to section (e) of Rule 17Ad-22.

<sup>28</sup> 12 U.S.C. 5464(a).

<sup>29</sup> 17 CFR 240.17Ad-22(e)(1).

of Rule 17Ad-22(e)(1).<sup>30</sup>

Rule 17Ad-22(e)(20) requires, in part, that a covered clearing agency establish, implement, maintain and enforce written policies and procedures reasonably designed to identify, monitor, and manage risks related to any link the covered clearing agency establishes with one or more other clearing agencies or financial market utilities.<sup>31</sup>

OCC is proposing to adopt the New Accord in order to address the risks it has identified related to its existing link with the NSCC within the Existing Accord. Specifically, under the terms of the Existing Accord, even after NSCC's guarantee has come into effect, OCC is not released from its guarantee with respect to the Options E&A until certain deadlines have passed on the first business day following the scheduled settlement date without NSCC notifying OCC that the relevant Common Member has failed to meet an obligation to NSCC and/or NSCC has ceased to act for such firm. This current process results in a period of time where NSCC's trade guarantee and OCC's guarantee both apply to the same positions, and, therefore, both clearing agencies are holding margin against the same Options E&A position. As a result, the Existing Accord provides for a more complicated framework for the settlement of certain Stock Options. These complications could give rise to inconsistencies with regard to the development and application of interdependent policies and procedures between OCC and NSCC, which could lead to unanticipated disruptions in OCC's or NSCC's clearing operations.

In connection with the proposal to enhance the timing of the Guaranty Substitution, the New Accord would provide for a clearer, simpler framework for the settlement of certain Stock Options and Stock Futures by pinpointing a specific moment

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<sup>30</sup> Id.

<sup>31</sup> 17 CFR 240.17Ad-22(e)(20).

in time, the Guaranty Substitution Time, at which guarantee obligations would transfer from OCC to NSCC. The New Accord would eliminate any ambiguity regarding which clearing agency is responsible for guaranteeing settlement at any given moment.

Establishing a precise Guaranty Substitution Time 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 and the system for the clearance and settlement of Stock Options and Stock Futures would continue with minimal interruption. This greater certainty would strengthen OCC's and NSCC's ability to plan for and manage, and therefore would mitigate, the risk presented by Common Member defaults to OCC and NSCC, other members, and the markets the clearing agencies serve. Therefore, through the adoption of the proposal to enhance the timing of the Guaranty Substitution, OCC would more effectively manage its risks related to the operation of the New Accord.

Moreover, in connection with the proposal to put additional arrangements into place concerning the procedures, information sharing, and overall governance processes under the New Accord, NSCC and OCC would agree to share certain information, including general surveillance information regarding their members, so that each clearing agency would be able to effectively identify, monitor, and manage risks that may be presented by certain Common Members. Accordingly, OCC believes the proposed changes are reasonably designed to identify, monitor, and manage risks related to the link established between OCC and NSCC for the settlement of certain Stock Options and Stock Futures in a manner consistent with Rule 17Ad-22(e)(20).<sup>32</sup>

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<sup>32</sup> Id.

Finally, Rule 17Ad-22(e)(21) requires that a covered clearing agency establish, implement, maintain and enforce written policies and procedures reasonably designed to, among other things, be efficient and effective in meeting the requirements of its participants and the markets it serves.<sup>33</sup> As noted above, under the Existing Accord, even after NSCC's guarantee has come into effect, OCC is not released from its guarantee with respect to the Options E&A until certain deadlines have passed on the first business day following the scheduled settlement date without NSCC notifying OCC that the relevant Common Member has failed to meet an obligation to NSCC and/or NSCC has ceased to act for such firm. This results in a period of time where NSCC's guarantee overlaps with OCC's guarantee and where both clearing agencies are holding margin against the same Options E&A positions. In connection with the proposal to enhance the timing of the Guaranty Substitution, the New Accord would minimize this "double margining" issue by introducing a new Guaranty Substitution Time, which would normally occur as soon as NSCC has received all Required Deposits to the Clearing Fund from Common Members, which have been calculated taking into account the relevant E&A/Delivery Transactions, rather than require reimbursement payments from one clearing agency to the other. As a result, Common Members would no longer be required to post margin at both clearing agencies to cover the same E&A/Delivery Transactions. OCC believes that, by simplifying the terms of the existing agreement in this way, the New Accord is designed to be efficient and effective in meeting the requirements of OCC's and NSCC's participants and the markets they serve.

Additionally, the proposal to put additional arrangements into place concerning

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<sup>33</sup> 17 CFR 240.17Ad-22(e)(21).

the procedures, information sharing, and overall governance processes under the New Accord would create new efficiencies in the management of this important link between OCC and NSCC. The proposal to enhance information sharing between OCC and NSCC would allow the clearing agencies to more effectively identify, monitor, and manage risks that may be presented by certain Common Members, and would create new efficiencies in their general surveillance efforts with respect to these firms.

In these ways, OCC believes the proposed New Accord is consistent with the requirements of Rule 17Ad-22(e)(21).<sup>34</sup>

### 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 the proposed change was filed with the Commission or (ii) the date any additional information requested by the Commission is received. OCC 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.

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Id.

OCC shall post notice on its website of proposed changes that are implemented.

The proposal shall not take effect until all regulatory actions required with respect to the proposal are completed.

#### 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-2017-804 on the subject line.

##### Paper Comments:

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

All submissions should refer to File Number SR-OCC-2017-804. 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 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of OCC and on OCC's website at

[http://www.theocc.com/components/docs/legal/rules\\_and\\_bylaws/sr\\_occ\\_17\\_804.pdf](http://www.theocc.com/components/docs/legal/rules_and_bylaws/sr_occ_17_804.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-2017-804 and should be submitted on or before [insert date 15 days from publication in the Federal Register].

By the Commission.

Robert W. Errett  
Deputy Secretary