

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-80372; File No. SR-OCC-2017-003)

April 4, 2017

Options Clearing Corporation Self-Regulatory Organizations; The; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Concerning the Requirement for Clearing Members to Participate in Default Management Testing

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on March 29, 2017, The Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II and III below; Items I and II have been prepared by OCC. OCC filed the proposed rule change pursuant to Section 19(b)(3)(A)(iii)<sup>3</sup> of the Act and Rule 19b-4(f)(6)<sup>4</sup> thereunder so that the proposal was effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Clearing Agency’s Statement of the Terms of Substance of the Proposed Rule Change

This proposed rule change by OCC codifies the requirement for Clearing Members to participate in default management testing.

II. Clearing Agency’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, OCC included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed

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

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

<sup>3</sup> 15 U.S.C. 78s(b)(3)(A)(iii).

<sup>4</sup> 17 CFR 240.19b-4(f)(6).

rule change. 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), (B), and (C) below, of the most significant aspects of these statements. All terms with initial capitalization that are not otherwise defined herein have the same meaning as set forth in the OCC By-Laws and Rules.<sup>5</sup>

(A) Clearing Agency’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

**Background**

On September 28, 2016 the Commission adopted amendments to Rule 17Ad-22<sup>6</sup> and added new Rule 17Ad-22(e)(13)<sup>7</sup> pursuant to Section 17A of the Securities Exchange Act of 1934<sup>8</sup> and the Payment, Clearing, and Settlement Supervision Act of 2010 (“Payment, Clearing and Settlement Supervision Act”)<sup>9</sup> to require that a “covered clearing agency,” as defined by Rule 17Ad-22(a)(5),<sup>10</sup> has the authority and operational capacity, among other things, to require that participants, and other stakeholders when practicable, participate in the review and testing of the covered clearing agency’s default procedures (collectively, the new and amended rules are herein referred to as “CCA” rules). Specifically, Rule 17Ad-22(e)(13) requires that a covered

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<sup>5</sup> OCC’s By-Laws and Rules can be found on OCC’s public website: <http://optionsclearing.com/about/publications/bylaws.jsp>.

<sup>6</sup> 17 CFR 240.17Ad-22.

<sup>7</sup> 17 CFR 240.17Ad-22(e)(13).

<sup>8</sup> 15 U.S.C. 78q-1.

<sup>9</sup> 12 U.S.C. 5461 *et. seq.*

<sup>10</sup> 17 CFR 240.17Ad-22(a)(5).

clearing agency establish, implement, maintain and enforce written policies and procedures reasonably designed to:

Ensure the covered clearing agency has the authority and operational capacity to take timely action to contain losses and liquidity demands and continue to meet its obligations by, at a minimum, requiring the covered clearing agency's participants and, when practicable, other stakeholders to participate in the testing and review of its default procedures, including any close-out procedure, at least annually and following material changes thereto.<sup>11</sup>

OCC meets the definition of a covered clearing agency and is therefore subject to the requirements of the CCA rules, including Rule 17Ad-22(e)(13).<sup>12</sup>

### **Current Practice**

As a matter of current practice, OCC already involves certain of its Clearing Members in testing of OCC's default management procedures. Article V of OCC's By-Laws sets forth OCC's initial membership requirements. Pursuant to Interpretation and Policy .02(b) of Article V, Section 1 of OCC's By-Laws, an applicant must demonstrate that it is operationally capable of, among other things, participating in applicable default management activities as required by OCC and in accordance with applicable laws and regulations.<sup>13</sup>

Once an applicant becomes a Clearing Member, Chapter II of OCC's Rules also sets forth operational requirements that address default management procedure testing. In particular, OCC Rule 214(d) requires Clearing Members to maintain certain operational capabilities as a

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<sup>11</sup> 17 CFR 240.17Ad-22(e)(13).

<sup>12</sup> Id.

<sup>13</sup> See OCC By-Laws Article V, Section 1, Interpretation and Policy .02(b).

continuing obligation of participating in OCC as a Clearing Member. This includes “the ability to participate in default management activities, including auctions, as may be required by the Corporation and in accordance with applicable laws and regulations.”<sup>14</sup>

As contemplated by Interpretation and Policy .02(b) of Article V, Section 1 and Rule 214(d), OCC already conducts periodic default management testing, which includes the participation of certain Clearing Members.

### **Proposed Rules 218(c) and (d)**

To comply with certain requirements in Rule 17Ad-22(e)(13) that the Commission recently adopted as part of the CCA rules, OCC is proposing to implement Rules 218(c) and (d) to establish a requirement that Clearing Members participate periodically in testing of OCC’s default procedures, including any close-out procedures. Proposed Rules 218(c) and (d) would make clear, consistent with the CCA rules, OCC’s right to designate Clearing Members that are required to participate in default procedure testing and require designated Clearing Members to comply with the default procedure testing within specified timeframes.

OCC maintains a Default Management Policy (“Policy”) that also addresses its default procedure testing requirements. Specifically, the Policy notes, among other things, that OCC’s default management testing will occur on at least an annual basis, or more frequently if a material change is made to OCC’s default management procedures or as may be deemed necessary by OCC’s internal “Default Management Working Group.”<sup>15</sup> In addition, the Policy

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<sup>14</sup> See OCC Rule 214(d).

<sup>15</sup> The “Default Management Working Group” is a staff-level working group chaired by the Vice President of Default Management and composed of staff from other OCC departments involved in default management testing.

provides that certain Clearing Members would be required to participate in OCC's default management testing, consistent with proposed Rules 218(c) and (d).

Proposed Rules 218(c) and (d) would establish flexible and transparent key factors that OCC would use to determine which Clearing Members are required to participate in default management testing. Proposed Rules 218(c) and (d) would require OCC to use the key factors to select Clearing Members that, taken as a whole, OCC determines are the minimum necessary for the maintenance of fair and orderly markets, the promotion of robust risk management, the support of stability of the broader financial system and the protection investors and the public interest. OCC's key factors in determining which Clearing Members will be selected for testing in any given testing event would include but not be limited to: (i) suitability of business activities and anticipated impact on resources;<sup>16</sup> (ii) historical open interest and volume in asset classes, where appropriate;<sup>17</sup> and (iii) participation in previous tests. In adopting the CCA rules, the Commission provided guidance that clarifies that "[a] covered clearing agency may designate in its policies and procedures that certain participants, or certain categories of participants, be

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<sup>16</sup> OCC's Clearing Members vary in their size, capacity, and participation in OCC's services from large, active members to smaller members that may not participate in certain services or may have less resources, personnel, or capacity to engage in default procedure testing at a given time. Consequently, OCC needs to preserve reasonable flexibility in considering the suitability of business activities and anticipated impact on resources of a Clearing Member considered for participation in a particular default management testing exercise. OCC notes, however, that this in no way abrogates a Clearing Member's obligations to maintain the minimal operational capabilities, including the ability to participate in default management activities, as required by OCC's rules. See e.g., OCC Rule 214(d).

<sup>17</sup> See, e.g., OCC Rule 1104.02(d), noting that in a default scenario OCC will pre-qualify certain potential bidders in an auction based on, among other things, demonstrated activity in the products being auctioned and qualification to clear transactions in the asset class in which the Clearing Member proposes to submit bids before inviting a bidder to participate in the auction.

designated for participation in certain tests.”<sup>18</sup> OCC’s key factors to determine which Clearing Members are selected for participation in a given test of a default procedure are designed to provide flexibility to OCC while also ensuring that the appropriate Clearing Members participate in tests relevant to their business activities as relevant to OCC. Any Clearing Members designated to participate in a test of OCC’s default procedures would be notified in advance and provided details concerning the nature of such testing as the particular test plans are determined.

As stated above, OCC already conducts periodic default management testing and includes certain Clearing Members in such testing under Rule 214(d). Accordingly, OCC believes the proposed rule would have comparatively little impact on its Clearing Members relative to OCC’s existing practice. As previously noted, the proposed rule is intended to establish clear authority in accordance with Rule 17Ad-22(e)(13)<sup>19</sup> for OCC to require Clearing Member participation in default procedure testing.

## 2. Statutory Basis

OCC believes that the proposed rule change is consistent with Section 17A(b)(3)(F) of the Act<sup>20</sup> because the proposed change would foster cooperation and coordination with persons engaged in the clearance and settlement of securities transactions by expressly establishing in OCC’s Rules that Clearing Members must participate in default procedure testing, which, in turn, would help to ensure that if OCC’s default procedures are activated, they would function as intended. OCC believes that the proposed rule change is also consistent with Rule 17Ad-

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<sup>18</sup> Securities Exchange Act Release No. 78961 (September 28, 2016), 81 FR 70786, 70830 (October 13, 2016).

<sup>19</sup> 17 CFR 240.17Ad-22(e)(13).

<sup>20</sup> 15 U.S.C. 78q-1(b)(3)(F).

22(e)(13)<sup>21</sup> because it would require Clearing Members to participate in the testing of OCC's default procedures, including any close-out procedures, which testing would occur at least annually and following any material changes to OCC's default management procedures.

OCC also believes that Clearing Members will benefit by having proposed Rules 218(c) and (d) clearly state their obligation to participate in default procedure testing if designated, as required under the CCA rules. Moreover, OCC believes that this legal framework would promote consistency with Rule 17Ad-22(e)(1)<sup>22</sup> by ensuring that OCC has a well-founded, clear, transparent and enforceable legal basis regarding default management procedure testing.

The proposed rule change is not inconsistent with the existing rules of OCC, including any other rules proposed to be amended.

(B) Clearing Agency's Statement on Burden on Competition

OCC does not believe that the proposed rule change would impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act.<sup>23</sup> Proposed Rules 218(c) and (d) would expressly establish OCC's authority to require Clearing Members to participate in particular default management procedure testing exercises. However, OCC does not believe that such a requirement – which is minimally necessary for compliance with Rule 17Ad-22(e)(13)<sup>24</sup> – imposes any burden on competition among Clearing Members, let alone any burden greater than necessary or appropriate in furtherance of the purposes of the Act. To begin, proposed Rules 218(c) and (d) would not impose disparate

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<sup>21</sup> 17 CFR 240.17Ad-22(e)(13).

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

<sup>23</sup> 15 U.S.C. 78q-1(b)(3)(I).

<sup>24</sup> 17 CFR 240.17Ad-22(e)(13).

operational requirements on Clearing Members because all Clearing Members are required to have sufficient minimum capabilities to participate in OCC's default management procedure testing process. Further, the process for selecting Clearing Member participants would be designed to ensure that Clearing Members would participate in tests that are relevant to their business activities, consistent with OCC's current practice. Finally, OCC believes that the limited, periodic use of Clearing Member resources in default management testing exercises would not affect the ability of a selected Clearing Member to continue to operate its business as it otherwise would. Accordingly, OCC believes the responsibilities associated with testing participation would be equitably distributed such that no Clearing Member(s) would face any burden on competition more than is necessary or appropriate in furtherance of the purposes of the Act and that the proposed rule change is therefore consistent with the requirements of the Act applicable to clearing agencies.

(C) Clearing Agency's Statement on Comments on the Proposed Rule Change 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.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Pursuant to Section 19(b)(3)(A) of the Act,<sup>25</sup> and Rule 19b-4(f)(6)<sup>26</sup> thereunder, the proposed rule change is filed for immediate effectiveness because it does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) by its terms would not become operative for 30 days after the date of the filing, or such shorter time as the Commission may designate. Additionally, OCC provided the

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<sup>25</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>26</sup> 17 CFR 240.19b-4(f)(6).



Commission with written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change or such shorter time as designated by the Commission.

OCC stated that the proposed rule change would not significantly affect the protection of investors or the public interest because, as described above, OCC already conducts periodic default management testing and includes certain Clearing Members in such testing, in accordance with Interpretation and Policy .02(b) of Article V, Section 1 of OCC's By-Laws and Rule 214(d). OCC stated further that proposed Rules 218(c) and (d) would only modify OCC's rules to clearly articulate the requirement that Clearing Members must participate periodically in testing of OCC's default management procedures. OCC believes that the proposed rule change would not impose any significant burden on competition because, as described above, OCC believes the responsibilities associated with testing participation would be nominal and infrequent and would be equitably distributed among Clearing Members by OCC using certain key factors, including but not limited to participation in previous tests.

A proposed rule change filed under Rule 19b-4(f)(6) normally does not become operative for 30 days after the date of filing. However, Rule 19b-4(f)(6)(iii) permits the Commission to designate a shorter time if such action is consistent with the protection of investors and the public interest. OCC has requested that the Commission waive the 30-day operative delay contained in Rule 19b-4(f)(6)(iii) so that the proposal may become operative immediately upon filing. According to OCC, the proposed rule change does not present any novel or controversial issues. OCC stated that this proposed rule change would require Clearing Members to participate in the testing of OCC's default procedures consistent with 17Ad-22(e)(13). In its proposal, OCC stated that the proposed rule change is not intended to

substantively alter OCC's default management testing procedures, but is instead intended to amend OCC's rules to clearly articulate the requirement that Clearing Members must participate in the testing of OCC's default management procedures. Therefore, the Commission designates the proposed rule change to be operative upon filing.<sup>27</sup>

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.<sup>28</sup>

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act.

Comments may be submitted by any of the following methods:

##### Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-OCC-2017-003 on the subject line.

##### Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

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<sup>27</sup> For purposes only of waiving the 30-day operative delay, the Commission has also considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>28</sup> Notwithstanding its immediate effectiveness, implementation of this rule change will be delayed until this change is deemed certified under CFTC Regulation §40.6.

All submissions should refer to File Number SR-OCC-2017-003. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, N.E., Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such 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\\_003.pdf](http://www.theocc.com/components/docs/legal/rules_and_bylaws/sr_occ_17_003.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-2017-003 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission by the Division of Trading and Markets, pursuant to delegated authority.<sup>29</sup>

Eduardo A. Aleman  
Assistant Secretary

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<sup>29</sup> 17 CFR 200.30-3(a)(12).