

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-82543; File No. SR-OCC-2018-003)

January 19, 2018

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Modify OCC's Rules Regarding the Exercise Procedures for Certain Options on Futures

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on January 11, 2018, 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, which Items have been prepared by OCC. OCC filed the proposed rule change pursuant to Section 19(b)(3)(A)³ of the Act and Rule 19b-4(f)(4)(ii)⁴ 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 concerns modifications to OCC's Rules regarding the exercise procedures for certain options on futures in order to conform to changes proposed by Nasdaq Futures, Inc. ("NFX"), a futures market for which OCC clears such contracts. The proposed changes to OCC's Rules can be found in Exhibit 5 to the filing. All terms with initial

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A).

⁴ 17 CFR 240.19b-4(f)(4)(ii).

capitalization that are not otherwise defined herein have the same meaning as set forth in the By-Laws and Rules.⁵

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 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.

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

(1) Purpose

The purpose of this proposed rule change is to amend OCC's Rules to permit a futures market that lists certain options on futures to instruct OCC to: (1) eliminate a Clearing Member's ability to provide contrary instructions with respect to such futures options, and (2) permit automatic exercise of futures options that are call options and that settle at exactly the strike price for the option (*i.e.*, an "at-the-money" futures option). These amendments to OCC's Rules would accommodate certain corresponding amendments to the rules of NFX, for which OCC clears relevant futures option contracts, and would not apply to any options on security futures to the extent OCC clears such products in the future.⁶

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

⁶ Options on security futures currently do not trade on the exchange for which OCC clears security futures. The proposed rule change would not apply to any securities, but rather futures products (*i.e.*, options on futures that are not security futures) that are subject to the exclusive jurisdiction of the Commodity Futures Trading Commission ("CFTC"). See *infra* note 16.

Contrary Instructions

NFX has proposed to eliminate the ability of the holders of certain futures options contracts to provide “contrary instructions” or “contrary exercises” to the futures markets with respect to such contracts.⁷ NFX has advised OCC that the New York Mercantile Exchange, Inc. (“NYMEX”) has already made comparable changes to its rules for certain comparable options traded on NYMEX based on market feedback.⁸ NFX would like to replicate these changes for the comparable options contracts traded on NFX, none of which are options on security futures.

A contrary instruction allows an option holder to exercise an “out-of-the-money” option to receive the underlying futures contract or to abandon an “in-the-money” option. Existing OCC Rule 1305 governs the exercise procedures for American and European-styled options on futures cleared by OCC that settle into the underlying futures contract. Subparagraph (c) of Rule 1305 provides for the automatic exercise of such options that are in-the-money at expiration by “such threshold amount as [OCC] may from time to time establish with respect to particular classes of options,” unless the Clearing Member instructs OCC not to exercise such in-the-money options. The provision also incorporates by reference certain operational aspects of the exercise-at-expiration procedures for listed options found in OCC Rule 805. Neither Rule 1305 nor Rule 805 provide a futures market with the ability to limit contrary instructions.

Consequently, OCC proposes to add a new paragraph (d) to Rule 1305 that would provide futures markets with this ability in order to accommodate NFX’s proposal to prohibit the use of contrary instructions. The proposed ability would not apply, however, to options on security futures cleared by OCC to the extent OCC clears such products in the future.

⁷ See SR-NFX-2017-56, filed December 15, 2017 with the CFTC.

⁸ See NYMEX Submission No. 17-272 filed July 21, 2017 with the CFTC. The filing also amended the rules of the Commodity Exchange, Inc. (“COMEX”) to make comparable changes for certain options traded on COMEX.

At-the-Money Options

Existing Rules 1305 and 805 are silent on what happens to options that expire at-the-money. By specifying what happens to options that expire in-the-money (i.e., automatic exercise), OCC's Rules indicate that options expiring at-the-money would be treated as if they were out-of-the-money and not automatically exercised, and therefore the holders would not automatically buy (or sell) futures contracts or equity securities at the strike price. NFX has proposed to amend its own rules regarding the treatment of certain at-the-money options. In order to accommodate these proposed changes at NFX, OCC proposes to add a new paragraph (e) to Rule 1305, which would permit a futures market to instruct OCC that futures options that are call options and settle at-the-money should be treated as if they settled in-the-money and futures options that are put options and settle at-the-money should be treated as if they settled out-of-the-money. However, the proposed ability would not apply to options on security futures that are cleared by OCC to the extent OCC clears such products in the future. Therefore, in the case of a call option the holder of the option would automatically buy the underlying futures contract at the option strike price, and in the case of a put option the holder would not automatically sell the underlying futures contract at the option strike price.

Timing of Implementation

OCC proposes that the proposed amendments to Rule 1305 would apply to any futures option for which a futures market has instructed OCC to apply the exercise procedures specified in Rules 1305(d) and/or (e).

(2) Statutory Basis

Section 17A(b)(3)(F) of the Act,⁹ requires, among other things, that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities and derivatives transactions, to foster cooperation and coordination with persons engaged in clearance and settlement, and, in general, to protect investors and the public interest. OCC believes that the proposed rule change is consistent with Section 17A(b)(3)(F) of the Act¹⁰ and the rules and regulations thereunder, because it would grant the futures markets for which OCC clears futures options contracts the ability to coordinate OCC's exercise procedures with the futures market's treatment of at-the-money options and to prohibit the use of contrary instructions, thereby promoting the prompt and accurate clearance and settlement of securities and derivatives transactions, fostering cooperation and coordination with persons engaged in clearance and settlement, and, in general, protecting investors and the public interest.

Rule 17Ad-22(e)(21)¹¹ requires that a covered clearing agency establish, implement, maintain and enforce written policies and procedures reasonably designed to, in part, be efficient and effective in meeting the requirements of its participants and the markets it serves. OCC believes that granting futures markets, like NFX, this flexibility would encourage efficiency and coordination across the market as a whole and reduce potential sources of operational risk for market participants. A lack of conformity in futures option contract terms across different futures markets could reduce efficiency and pose operational risks to market participants and would require them to undertake additional monitoring. OCC therefore believes that the

⁹ 15 U.S.C. 78q-1(b)(3)(F).

¹⁰ Id.

¹¹ 17 CFR 240.17Ad-22(e)(21).

proposed rule change is reasonably designed to comply with the requirements of Rule 17Ad-22(e)(21).¹²

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

Section 17A(b)(3)(I) of the Act¹³ requires that the rules of a clearing agency not impose any burden on competition not necessary or appropriate in furtherance of the Act. OCC does not believe that the proposed rule change would impact or impose any burden on competition. This proposed rule change would not inhibit access to OCC's services or disadvantage or favor any particular user in relationship to another, and it will be applied uniformly to all Clearing Members. The proposed rule change is intended to accommodate NFX's proposed rule change, which is designed to bring the terms of the futures options contracts listed by NFX into conformity with those listed by other futures markets. Accommodating such a change would help promote a level playing field among market participants trading futures options by ensuring that such contracts could have identical terms. For the foregoing reasons, OCC believes the proposed rule change is in the public interest, would be consistent with the requirements of the Act applicable to clearing agencies, and would not impact or impose a burden on competition.

(C) Clearing Agency's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

Written comments on the proposed rule change were not and are not intended to be solicited with respect to the proposed rule change and none have been received.

¹²

Id.

¹³

15 U.S.C. 78q-1(b)(3)(I).

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

Pursuant to Section 19(b)(3)(A) of the Act,¹⁴ and Rule 19b-4(f)(4)(ii) thereunder,¹⁵ the proposed rule change is filed for immediate effectiveness because it effects a change in an existing service of OCC that (i) primarily affects the clearing operations of OCC with respect to products that are not securities, i.e., options on futures that are not security futures,¹⁶ and (ii) does not significantly affect any securities clearing operations of OCC or any rights or obligations of OCC with respect to securities clearing or persons using such securities clearing services.

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

¹⁴ 15 U.S.C. 78s(b)(3)(A).

¹⁵ 17 CFR 240.19b-4(f)(4)(ii).

¹⁶ Section 3(a)(10) of the Act defines a “security” as “any note, stock, treasury stock, security future, security-based swap, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any instrument commonly known as a ‘security’; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker’s acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.” 15 U.S.C. 77b(a)(1). Section 3(a)(55) of the Exchange Act defines “security future” as “a contract of sale for future delivery of a single security or of a narrow-based security index, including any interest therein or based on the value thereof, except an exempted security.” 15 U.S.C. 78c(a)(55). An option on a futures contract that is not a security future does not meet the definition of “security” and therefore is a product that is subject to the exclusive jurisdiction of the CFTC.

action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.¹⁷

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. Please include File Number SR-OCC-2018-003 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.

All submissions should refer to File Number SR-OCC-2018-003. 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

¹⁷ Notwithstanding its immediate effectiveness, implementation of this rule change will be delayed until this change is deemed certified under CFTC Rule 40.6.

Street, NE, 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 <https://www.theocc.com/about/publications/bylaws.jsp>.

All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly.

All submissions should refer to File Number SR-OCC-2018-003 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.¹⁸

Eduardo A. Aleman
Assistant Secretary

¹⁸ 17 CFR 200.30-3(a)(12).