

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 300

[Release No. SIPA-171; File No. SIPC-2012-01]

Securities Investor Protection Corporation

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities Investor Protection Corporation (“SIPC”) filed a proposed rule change with the Securities and Exchange Commission (“Commission”). The proposed rule change amends SIPC Rule 400, entitled “Rules Relating to Satisfaction of Customer Claims for Standardized Options,” which relates to the satisfaction of customer claims for standardized options under the Securities Investor Protection Act of 1970 (“SIPA”). The Commission is publishing the proposed rule change for public comment. Because SIPC rules have the force and effect as if promulgated by the Commission, those rules are published in Title 17 of the Code of Federal Regulations.

DATES: Comments are to be received on or before November 26, 2013.

ADDRESSES: Interested persons are invited to submit written data, views, and arguments concerning the foregoing by any of the following methods:

Electronic comments:

- Use the Commission’s Internet comment form (<http://www.sec.gov/rules/other.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SIPC-2012-01 on the subject line.

Paper comments:

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

All submission letters should refer to File Number SIPC-2012-01. 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/other.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, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. 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.

FOR FURTHER INFORMATION CONTACT: Michael A. Macchiaroli, Associate Director, at (202) 551-5525; Thomas K. McGowan, Deputy Associate Director, at (202) 551-5521; Sheila Dombal Swartz, Special Counsel, at (202) 551-5545; or Kimberly N. Chehardy, Special Counsel, at (202) 551-5791, Office of Financial Responsibility, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-7010.

SUPPLEMENTARY INFORMATION: Pursuant to Section 3(e)(2)(A) of SIPA,¹ notice is hereby given that SIPC filed with the Commission on November 7, 2012, a proposed rule change, as described in Item I below, which item has been substantially prepared by SIPC. On January 31, 2013, SIPC filed Amendment No. 1 to the proposed rule change.² The Commission is publishing this notice to solicit comments on the proposed rule change, as modified by Amendment No. 1, from interested persons.

I. SIPC’S STATEMENT OF THE PURPOSE OF, AND STATUTORY BASIS FOR, THE PROPOSED RULE CHANGE

In its filing with the Commission, SIPC 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 above. SIPC has prepared the following summary of the purpose of and statutory basis for the proposed rule change.³

SIPC Rule 400, 17 CFR 300.400 (“Rule 400” or “the Rule”), was enacted to provide clarity in the treatment of customer claims based on “Standardized Options” positions, in the liquidation of broker-dealers under SIPA. Currently, Rule 400 generally provides for the closeout of open Standardized Options positions upon the commencement of a SIPA liquidation. Based upon the amounts realized upon closeout, the trustee calculates the value of customers’ Standardized Options positions, and credits or debits customers’ accounts by the appropriate amounts. The purpose of the proposed rule change is to amend SIPC Rule 400 in the following

¹ 15 U.S.C. 78ccc(e)(2)(A).

² Amendment No. 1 is a partial amendment which modifies the initial proposed changes to subsection (h) of Rule 400, by inserting the phrase “a ‘security’ under section 16(14) of the Act and is” prior to the words “issued by a securities clearing agency”

³ The Commission has modified the language in this section.

respects: (1) to provide trustees appointed under SIPA with greater flexibility in the distribution of Standardized Options upon the commencement of a SIPA liquidation proceeding; and (2) to modify the definition of Standardized Options under Rule 400(h), to include an option that is a “security” under SIPA and is issued by an SEC-registered securities clearing agency or a foreign securities clearing agency, i.e., an over-the-counter option (“OTC Option”). The proposed amendments create an alternative to closeout by allowing the SIPA trustee, with SIPC’s consent, to transfer some or all of such Standardized Options positions to another SIPC member for the accounts of customers.

Under SIPC Rule 400(h), “Standardized Options” means options traded on a national securities exchange, an automated quotation system of a registered securities association, or a foreign securities exchange. The proposed amendments also would modify the definition of “Standardized Options” to include any other option that is a “security” under section 16(14) of SIPA and is issued by a registered securities clearing agency or foreign securities clearing agency.⁴ For example, the Options Clearing Corporation (“OCC”) proposed, and the Commission approved, a rule change to establish a legal and operational framework for OCC to provide central clearing for OTC Options.⁵ If OCC clears OTC Options, these options will be deemed “Standardized Options” and subject to closeout or transfer in a SIPA proceeding.

⁴ Existing Rule 400 applies to options traded on foreign securities exchanges as well as U.S. exchanges. For consistency, amended Rule 400 will apply to OTC options issued by foreign securities clearing agencies as well as U.S.-registered clearing agencies.

⁵ See Securities Exchange Act Release No. 67835 (Sept. 12, 2012), 77 FR 57602 (Sept. 18, 2012), (SR-OCC-2012-14); see also Securities Exchange Act Release No. 68434 (Dec. 14, 2012), 77 FR 75243 (Dec. 19, 2012) (approving proposed rule change). OCC also filed, and received accelerated approval of, a proposed rule change to reflect enhancements in its system for theoretical analysis and numerical simulations as applied to longer-tenor options. Securities Exchange Act Release No. 70719 (Oct. 18, 2013), 78 FR 63548 (Oct. 24, 2013), (SR-OCC-2013-16).

In light of experience and knowledge gained from the liquidation of Lehman Brothers Inc. (“Lehman”) and other SIPA proceedings, SIPC has determined that allowing SIPA trustees the flexibility, subject to SIPC approval, of transferring customers’ options positions or of liquidating their positions, would be beneficial to the investing public and consistent with the customer protection purposes of SIPA. Moreover, because the OTC Options are similar to exchange-traded index options, and generally would be cleared by a securities clearing agency registered under Section 17A of the Exchange Act subject to the same basic rules and procedures used for the clearance of index options, there appears to be no practical basis to treat OTC Options differently under SIPA. Indeed, modifying the definition of “Standardized Options” under Rule 400(h) to include OTC Options would update, and therefore enhance, the protections afforded customers in the event of a liquidation of their broker-dealer.

A. Past Experience

The ability to transfer Standardized Options positions to another brokerage in lieu of an automatic closeout gives SIPA trustees more flexibility in distributing such customer assets after the commencement of a SIPA liquidation proceeding, and more closely approximates what the customer would expect to be in his account but for the failure of the broker-dealer. This is particularly true where the trustee, as in the Lehman case, was able promptly to effectuate bulk transfers of customer accounts to other brokerages enabling customers to re-gain access to their accounts in the form in which the accounts existed pre-liquidation, with comparatively minimal disruption. In such instances, customers generally are better served by having their options positions transferred with their other securities to their accounts at their new broker-dealer. The proposed amendments would provide clear authority for a SIPA trustee to transfer the Standardized Options positions, with SIPC’s consent. This greater flexibility in the treatment of

open positions would enhance customer protection under exigent circumstances, and potentially avoid exacerbating the turmoil or harm to customers and/or the markets that could be caused by the forced liquidation of open positions.

B. OTC Options

In view of the potential clearing of OTC Options, modifying the definition of Standardized Options to include such options is appropriate and in keeping with the customer protection functions of SIPA. OTC Options will be “securities” for purposes of both the Securities Act of 1933 and the Exchange Act. They also will be a “security” under section 16(14) of SIPA, 15 U.S.C. §7811(14), which provides that that the term “security” means “any put, call, straddle, option, or privilege on any security, or group or index of securities” (emphasis added).

In a SIPA liquidation, customers would be protected against the loss of their OTC Options custodied with the SIPC member broker-dealer. Section 16(2) of SIPA, 15 U.S.C. §7811(2), provides that “[t]he term ‘customer’ of a debtor means any person ... who has a claim on account of securities received, acquired, or held by the debtor in the ordinary course of business” OTC Options will be created in the customers’ account and held there by the clearing member for the benefit of its customers in the same way that Standardized Options are held. A clearing agency will be the issuer of those options in precisely the same way that it is the issuer of listed options. Thus, the OTC Options created in the omnibus customers’ account of a clearing member at a clearing agency would be “received, acquired, or held” by the customer’s broker-dealer in the ordinary course of business.

For example, OTC Options at OCC will be carried in a clearing member’s clearing accounts. Proprietary positions will be carried in the clearing member’s firm account, and

customer positions in its securities customers' account. Positions in OTC Options will be margined at OCC in the omnibus customers' account on the same basis as listed options. If a clearing member takes the other side of a transaction with its customer in an OTC Option, the transaction will result in the creation of a long or short position (as applicable) in the omnibus customers' account and in the opposite position in the clearing member's firm account.

OCC indicates that it expects to clear the OTC Options subject to the same basic rules and procedures used for the clearance of index options. OCC will require that the transactions be cleared through a clearing member of OCC that is registered with the SEC as a broker-dealer, or one of the small number of clearing members that are "non-U.S. securities firms" as defined in OCC's By-Laws. Further, the OTC Options that OCC will clear will be options on the S&P 500 Index.⁶ The OTC Options will be similar to exchange-traded index options called "FLEX Options" that currently are traded on the Chicago Board Options Exchange. While the OTC Options will allow for customization of certain terms, such as the type of option, exercise price, and expiration date, OTC Options will not be exchange traded. Rather, they will be bilateral trades that will be submitted to OCC for clearance.

II. DATE OF EFFECTIVENESS OF THE PROPOSED RULE CHANGE AND TIMING FOR COMMISSION ACTION

Within thirty-five days of the date of publication of this notice in the Federal Register, or within such longer period (i) as the Commission may designate of not more than ninety days after such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which SIPC consents, the Commission shall:

(A) By order approve such proposed rule change or

⁶ OCC is licensed by S&P to clear options on the S&P MidCap 400 Index and the S&P Small Cap 600 Index, and in the future, OCC may decide to clear OTC Options on other indices, or on individual equity securities.

(B) Institute proceedings to determine whether such proposed rule change should be disapproved.

To allow public access to SIPC's rules, SIPC rules that are approved by the Commission are published under Part 300 of 17 CFR Chapter II.

III. STATUTORY AUTHORITY

Pursuant to SIPA, 15 U.S.C. 78aaa et. seq., and particularly, section 3(e) (15 U.S.C. 78ccc(e)), SIPC proposes to amend 300.400 of Title 17 of the Code of Federal Regulations in the manner set forth below.

List of Subjects in 17 CFR Part 300

Brokers, Securities.

Text of the Amendments

In accordance with the foregoing, Title 17, Chapter II of the Code of Federal Regulations is proposed to be amended as follows:

PART 300 – RULES OF THE SECURITIES INVESTOR PROTECTION CORPORATION

1. The authority citation for part 300 is revised to read as follows:

Authority: 15 U.S.C. 78ccc.

* * * * *

2. Section 300.400 is amended by:

- a. In paragraph (b), adding the phrase “except to the extent that the trustee, with SIPC’s consent, or SIPC as trustee, as the case may be, has arranged or is able promptly to arrange, a transfer of some or all of such positions to another SIPC member” after the phrase “accounts of customers”;

- b. In paragraph (e), adding the phrase “except to the extent that such positions have been transferred as provided in paragraph (b) of this section” after the phrase “section 7(b)(1) of the Act”; and
- c. In paragraph (h), adding the phrase “, and any other option that is a security under section 16(14) of the Act, 15 U.S.C. 78lll(14), and is issued by a securities clearing agency registered under Section 17A of the Securities Exchange Act of 1934, 15 U.S.C. 78q-1, or a foreign securities clearing agency” after the phrase “foreign securities exchange”.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁷

Kevin M. O’Neill
Deputy Secretary

Date: October 29, 2013

⁷ 17 CFR 200.30-3(f)(3).