

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-74073; File No. SR-OCC-2014-812)

January 15, 2015

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of Advance Notice Concerning Extended and Overnight Trading Sessions

Pursuant to Section 806(e)(1) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act entitled the Payment, Clearing, and Settlement Supervision Act of 2010¹ (“Payment, Clearing and Settlement Supervision Act”) and Rule 19b-4(n)(1)(i) under the Securities Exchange Act of 1934² notice is hereby given that on December 12, 2014, The Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission (“Commission”) the advance notice as described in Items I and II below, which Items have been prepared by OCC.³ 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 by OCC in connection with a proposed change to its operations concerning the clearance of confirmed trades executed in extended and overnight trading sessions (hereinafter, “overnight trading sessions”) offered by exchanges for which OCC provides clearance and settlement services.

¹ 12 U.S.C. 5465(e)(1).

² 17 CFR 240.19b-4(n)(1)(i).

³ OCC initially filed a similar advance notice on September 17, 2014. Securities Exchange Act Release No. 73343 (October 14, 2014), 79 FR 62684 (October 20, 2014), (SR-OCC-2014-805). OCC withdrew that advance notice on October 28, 2014. Securities Exchange Act Release No. 73710 (December 1, 2014), 79 FR 72225 (December 5, 2014), (SR-OCC-2014-805).

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 on the advance notice were not and are not intended to be solicited with respect to the advance notice and none have been received.

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

Description of Change

This advance notice is being filed in connection with a proposed change to OCC's operations concerning the clearance of confirmed trades executed in overnight trading sessions offered by exchanges for which OCC provides clearance and settlement services. OCC currently clears overnight trading activity for CBOE Futures Exchange, LLC ("CFE").⁴ The total number of trades submitted to OCC from overnight trading sessions is nominal, typically less than 3,000 contracts per session. However, OCC has recently observed an industry trend whereby exchanges are offering overnight trading sessions beyond traditional hours. Exchanges offering overnight trading sessions have indicated

⁴ ELX Futures LP ("ELX") previously submitted overnight trading activity to OCC, but currently does not submit trades from overnight trading sessions to OCC. OCC will re-evaluate ELX's risk controls in the event ELX re-institutes its overnight trading sessions.

that such sessions benefit market participants by providing additional price transparency and hedging opportunities for products traded in such sessions, which, in turn, promotes market stability.⁵ In light of this trend, OCC proposes to implement a framework for clearing trades executed in such sessions that includes: 1) qualification criteria used to approve clearing members for overnight trading sessions, 2) systemic controls to identify trades executed during overnight trading sessions by clearing members not approved for such sessions, 3) enhancements to OCC's overnight monitoring of trades submitted by exchanges during overnight trading sessions, 4) enhancements to OCC's credit controls with respect to monitoring clearing members' credit risk during overnight trading sessions, including procedures for contacting an exchange offering overnight trading sessions in order to invoke use of the exchange's kill switch, and 5) taking appropriate disciplinary action against clearing members who attempt to clear during overnight trading session without first obtaining requisite approvals. These changes (described in greater detail below) are designed to reduce and mitigate the risks associated with clearing trades executed in overnight trading sessions. In addition, the only products that will be eligible for overnight trading sessions are index options and index futures products.

OCC's standards for determining whether to provide clearing services for overnight trading sessions offered by an exchange and the implementation of a framework are designed to work in conjunction with the risk controls of the exchanges that offer overnight trading sessions. OCC would confirm an exchange's risk controls as well as its staffing levels as they relate to overnight trading sessions to determine if OCC

⁵ See CFE-2014-010 at <http://cfe.cboe.com/publish/CFerulefilings/SR-CFE-2014-010.pdf>.

may reasonably rely on such risk controls to reduce risk presented to OCC by the exchange's overnight trading sessions. Such exchange risk controls will consist of: 1) price reasonability checks, 2) controls to prevent orders from being executed beyond a certain percentage (determined by the exchange) from the initial execution price, 3) activity based protections which focus on risk beyond price, such as a high number of trades occurring in a set period of time, and 4) kill switch capabilities, which may be initiated by the exchange and can cancel all open quotes or all orders of a particular participant. OCC believes that confirming the existence of applicable pre-trade risk controls as well as overnight staffing at the relevant exchanges is essential to mitigating risks presented to OCC from overnight trading sessions.⁶ Providing clearing services to exchanges offering such sessions is consistent with OCC's mission to provide market participants with clearing and risk management solutions that respond to changes in the marketplace and may result in increased cleared contract volume.

Qualification Criteria

In order to mitigate risks associated with clearing for overnight trading sessions, clearing members that participate in such trading sessions would be required to provide contact information to OCC for operational and risk personnel available to be contacted by OCC during such sessions. In addition, OCC would require that clearing members

⁶ Comparable controls are applied to futures and future option trades executed in overnight trading sessions currently cleared by OCC, although such controls have been implemented by clearing futures commission merchants ("clearing FCMs") pursuant to Commodity Futures Trading Commission ("CFTC") Regulation 1.73, which also requires such clearing FCMs to monitor for adherence to such controls during regular and overnight trading sessions. OCC believes that it may reasonably rely on such regulation to reduce risk presented to OCC during futures markets overnight trading sessions. *See* 17 CFR 1.73. OCC also confirmed CFE maintains kill switch capabilities.

participating in an overnight trading session to post additional margin in a designated account in order to mitigate against the risk that OCC cannot draft a clearing member's bank account during an overnight trading session.⁷ OCC would also adopt a procedure whereby, on a quarterly basis, it confirms its record of clearing members eligible for overnight trading sessions with a similar record maintained by exchanges offering such overnight trading sessions.

With respect to providing operational and risk contacts, under OCC Rule 201, each clearing member is required to maintain facilities for conducting business with OCC, and a representative of the clearing member authorized in the name of the clearing member to take all action necessary for conducting business with OCC is required to be available at the facility during such hours as may be specified from time-to-time by OCC. Similarly, OCC Rules 214(c) and (d) require clearing members to ensure that they have the appropriate number of qualified personnel and to maintain the ability to process anticipated volumes and values of transactions. OCC would use this existing authority to require clearing members trading during overnight trading sessions to maintain operational and risk staff that may be contacted by OCC during such sessions.

OCC would impose upon clearing members qualified to participate in overnight trading sessions additional margin requirement in an amount of the lesser of \$10 million or 10% of the clearing member's net capital ("Additional Margin"), which would be equal to the first monitoring risk threshold (described below) and which would be collected the morning before each overnight trading sessions. Clearing members must

⁷ Clearing members will be required to designate a firm account to ensure that OCC has a general lien on the assets in the account and can use them to satisfy any obligation of the clearing member to OCC.

identify the proprietary account that would be charged the Additional Margin amount. The Additional Margin requirement is intended to provide OCC with additional margin assets should a clearing member's credit risk increase during overnight trading sessions.⁸ OCC proposes to adopt a process whereby each morning OCC Financial Risk Management staff would assess the Additional Margin requirement against clearing members eligible to participate in overnight trading sessions. Clearing members that do not have sufficient excess margin on deposit with OCC to meet the Additional Margin amount would be required to deposit additional funds with OCC to satisfy the Additional Margin requirement.⁹ This process would be adopted under existing rule authority.

Moreover, OCC also would confirm that an exchange offering overnight trading sessions has adopted a procedure whereby such exchange would contact OCC when a trader requests trading privileges during overnight trading sessions. The purpose of this contact is to verify that the trader's clearing firm (*i.e.*, the OCC clearing member) is approved for overnight trading sessions. If the applicable OCC clearing member is not approved for overnight trading sessions, then the clearing member must receive OCC's approval for overnight trading sessions, or the exchange would not provide the trader trading privileges during overnight trading sessions. Moreover, OCC would confirm that an exchange offering overnight trading sessions has implemented a procedure to periodically (*i.e.*, quarterly) validate its record of approved clearing firms against OCC's

⁸ Clearing members approved for overnight trading sessions who do not meet the Additional Margin requirement for a given overnight trading session would be treated like a clearing member not approved overnight trading sessions, as described below.

⁹ Under OCC Rule 601, OCC has the discretion to fix the margin requirement for any account at an amount that it deems necessary or appropriate under the circumstances to protect the interests of clearing members, OCC and the public.

record of clearing members approved for overnight trading sessions. Any discrepancies between the two records would be promptly resolved by either the clearing member obtaining approval at OCC for overnight trading sessions, or by the exchange revoking the clearing firm's trading privileges for overnight trading sessions.

Systemic Controls

OCC plans to implement system changes so that trades submitted to OCC during overnight trading sessions that have been executed by clearing members not approved for such trading sessions would be reviewed by OCC staff after acceptance but before being processed (each such trade a [sic] being a "Reviewed Trade"). OCC would contact the submitting exchange regarding each Reviewed Trade in order to determine if the trade is a valid trade. If the exchange determines that the Reviewed Trade was in error such that, as provided in Article VI, Section 7(c), new or revised trade information is required to properly clear the transaction, OCC expects the exchange would instruct OCC to disregard or "bust" the trade. If the exchange determines that the Reviewed Trade was not in error, then OCC would clear the Reviewed Trade and take appropriate disciplinary action against the non-approved clearing member, as described below. OCC believes that clearing the Reviewed Trade is appropriate in order to avoid potentially harming the clearing member approved for overnight trading sessions that is on the opposite side of the transaction.

Overnight Monitoring

OCC plans to implement additional overnight monitoring in order to better monitor clearing members' credit risk during overnight trading sessions. Such monitoring of credit risk is similar to existing OCC practices concerning futures cleared

during overnight trading hours and includes automated processes within ENCORE to measure, by clearing member: (i) the aggregate mark-to-market amounts of a clearing member's positions, including positions created during overnight trading, based on current prices using OCC's Portfolio Revaluation system, (ii) the aggregate incremental margin produced by all positions resulting from transactions executed during overnight trading, and (iii) with respect to options cleared during overnight trading hours, the aggregate net trade premium positions resulting from trades executed during overnight trading (each of these measures being a "Credit Risk Number"). Hourly credit reports would be generated by ENCORE containing the Credit Risk Numbers expressed in terms of both dollars and, except for the mark-to-market position values, as a percentage of net capital for each clearing member trading during overnight trading sessions. The Credit Risk Numbers are the same information used by OCC staff to evaluate clearing member exposure during regular trading hours and, in addition to OCC's knowledge of its clearing members' businesses, are effective measures of the risk presented to OCC by each clearing member. OCC's Operations staff would review such reports as they are generated and, in the event that any of the Credit Risk Numbers for positions established by a clearing member during an overnight trading session exceeds established thresholds, staff would alert OCC's Market Risk staff¹⁰ of the exceedance in accordance with established procedures, as described below. Market Risk staff would follow a standardized process concerning such exceedances, including escalation to OCC's management, if required by such process. Given the nominal volume of trades executed

¹⁰ OCC's Member Services staff will also receive alerts in order to contact clearing members as may be necessary.

in overnight trading sessions that are presently submitted for clearance, no changes in current staffing levels that support overnight clearing activities is contemplated at this time, however, such staffing levels will be periodically assessed and adjusted, as appropriate. As part of the overnight clearing activities, OCC has, however, designated an on-call Market Risk duty officer who would be responsible for reviewing issues that arise when clearing for overnight trading session and determining what measures to be taken as well as additional escalation, if necessary.

With respect to OCC's escalation thresholds, if any Credit Risk Number of a clearing member approved for overnight trading sessions is \$10 million or more, or any Credit Risk Number equals 10% or more of the clearing member's net capital, OCC's Operations staff would be required to provide e-mail notification to Market Risk and Member Services staff. If any Credit Risk Number of a clearing member not approved for overnight trading sessions is \$10 million or more, or any Credit Risk Number equals 10% or more of the clearing member's net capital, OCC's Operations would also notify Market Risk and Member Services staff as well as its senior management. Such departments would take action to prevent additional trading by the non-approved clearing member, including contacting the exchange to invoke use of the exchange's kill switch.

If any Credit Risk Number of a clearing member approved for overnight trading sessions is \$50 million or more, or equals 25% or more of the clearing member's net capital, Operations staff would be required to contact, by telephone: (i) Market Risk and Member Services, (ii) the applicable exchange for secondary review, and (iii) the clearing member's designated contacts. The on-call Market Risk duty officer would also consider if additional action is necessary, which may include contacting a designated executive

officer in order to issue an intra-day margin call, increase the clearing member's margin requirement in order to prevent the withdrawal of a specified amount of excess margin collateral, if any, the clearing member has on deposit with OCC or contacting the exchange in order to invoke use of its kill switch. If any Credit Risk Number is \$75 million or more, or equals 50% or more of the clearing member's net capital, Operations staff would be required to contact, by telephone, Market Risk staff, the on-call Market Risk duty officer and a designated executive officer. Such officer would be responsible for reviewing the situation and determining whether to implement credit controls, which are described in greater detail below and include: issuing an intra-day margin call, increasing a clearing member's margin requirement in order to prevent the withdrawal of a specified amount of excess margin collateral, if any, the clearing member has on deposit with OCC, whether further escalation is warranted in order for OCC to take protective measures pursuant to OCC Rule 305, or contact the exchange in order to invoke use of its kill switch. OCC chose the above described escalation thresholds based on its analysis of historical overnight trading activity across the futures industry. OCC believes that these thresholds strike an appropriate balance between effective risk monitoring and operational efficiency.

Credit Controls

In order to address credit risk associated with trading during overnight trading sessions, and as described above, OCC would collect Additional Margin from clearing members as well as monitor and analyze the impact that positions established during such sessions have on a clearing member's overall exposure. Should the need arise based on threshold breaches described above, and pursuant to OCC Rule 609, OCC may require

the deposit of additional margin (“intra-day margin”) by any clearing member that increases its incremental risk as a result of trading activity during overnight trading sessions. Accordingly, a clearing member’s positions established during such sessions will be incorporated into OCC’s intra-day margin process. Should a clearing member’s exposure significantly increase while settlement banks are not open to process an intra-day margin call, OCC has the authority under OCC Rule 601 to increase a clearing member’s margin requirement which would restrict its ability to withdraw excess margin collateral. The implementation of these measures is discussed more fully below.

In the event that a clearing member’s exposure during overnight trading sessions causes a clearing member to exceed OCC’s intra-day margin call threshold for overnight trading sessions, OCC would require the clearing member to deposit intra-day margin equal to the increased incremental risk presented by the clearing member. Specifically, if a clearing member has a total risk charge¹¹ exceeding 25% (a reduction of the usual figure of 50%), as computed overnight by OCC’s STANS system, and a loss of greater than \$50,000 from an overnight trading session(s), as computed by Portfolio Revaluation, OCC would initiate an intra-day margin call. OCC would know at approximately 8:30 a.m. (Central Time) if an intra-day margin call on a clearing member would be initiated based on breaches of these thresholds. This “start of business” margin call is in addition to daily margin OCC collects from clearing members pursuant to OCC Rule 605, any intra-day margin call that OCC may initiate as a result of regular trading sessions or special margin call that OCC may initiate.

¹¹ Total risk charge is a number derived from STANS outputs and is the sum of expected shortfall, stress test charges and any add-on charges computed by STANS. STANS is OCC’s proprietary margin methodology.

In addition to, or instead of, requiring additional intra-day margin, OCC Rule 601¹² and OCC's Clearing Member Margin Call Policy work together to authorize Market Risk staff to increase a clearing member's margin requirement which may be in an amount equal to an intra-day margin call.¹³ (Any increased margin requirement will remain in effect until the next business day.) This action would immediately prevent clearing members from withdrawing any excess margin collateral (in the amount of the increased margin requirement) the clearing member has deposited with OCC. With respect to clearing trades executed in overnight trading sessions, and in the event OCC requires additional margin from a clearing member, Market Risk staff may use increased margin requirements as a means of collateralizing the increase in incremental risk a clearing member incurred during such sessions without having to wait for banks to open to process an intra-day margin call.¹⁴ Such action may be taken by OCC instead of or in addition to issuing an intra-day margin call depending on the amount of excess margin a clearing member has on deposit with OCC and the amount of the incremental risk presented by such clearing member. The expansion of OCC's intra-day margin call process as described in the preceding paragraph, including OCC's ability to manually increase clearing members' margin requirements, would mitigate the risk that OCC is under-collateralized as a result of overnight trading hours.

¹² In addition, OCC Rule 601 provides OCC with the authority to fix the margin requirement for any account or any class of cleared contracts at such amount as it deems necessary or appropriate under the circumstances to protect the respective interests of clearing members, OCC and the public.

¹³ Clearing members frequently deposit margin at OCC in excess of requirements.

¹⁴ Clearing members would be able to substitute the locked-up collateral during normal time frames (i.e., 6:00 a.m. to 5:00 p.m. (Central Time) for equity securities).

Moreover, a designated executive officer may call an exchange offering overnight trading sessions to invoke use of its kill switch. The kill switch would prevent a clearing member (or the market participant clearing through a clearing member) from executing trades on the exchange during a given overnight trading session or, if needed, stop all trading during a given overnight trading session. Finally, pursuant to OCC Rule 305, the Executive Chairman or the President of OCC, in certain situations, has the authority to impose limitations and restrictions on the transactions, positions and activities of a clearing member. This authority would be used, as needed, in the event a clearing member accumulates significant credit risk during overnight trading sessions, or a clearing member's activities during such trading sessions otherwise warrant OCC taking protective action.

Rule Enforcement Actions

In order to deter clearing members from attempting to participate in overnight trading sessions without authorization as well as appropriately enforce the above described processes, OCC would ensure that any attempt by a clearing member to participate in overnight trading sessions without first obtaining the necessary approval would result in the initiation of a rule enforcement action against such clearing member. As described above, clearing members not approved for overnight trading sessions who trade during such overnight sessions would have their trades reviewed by OCC staff. Clearing members who attempted to participate in overnight trading sessions that did not obtain the necessary approval to do so would be subject to a minor rule violation fine.¹⁵ In addition, if a clearing member's operational or risk contacts for overnight trading

¹⁵ See OCC Rule 1201(b).

sessions were unavailable had OCC attempted to contact such individuals, the clearing member would be subject to a minor rule violation fine. OCC has existing processes in place to monitor for clearing member violations of OCC's rules and such processes would also apply to clearing member activity during overnight trading sessions.

Anticipated Effect on and Management of Risk

Clearing transactions executed in overnight trading sessions may increase risk presented to OCC due to the period of time between trade acceptance and settlement, the staffing levels at clearing members during such trading sessions and the deferment of executing intra-day margin calls until banking settlement services are operational. However, OCC would expand its risk management practices in order to mitigate these risks by implementing, and expanding, the various tools discussed above. For example, OCC would enhance its monitoring practices in order to closely monitor clearing members' credit risk from trades placed during overnight trading sessions as well as implement processes so that OCC takes appropriate action when such credit risk exceeds certain limits. OCC would also use its existing authority to require adequate clearing member staffing during such trading sessions, in order to mitigate the operational risk associated with clearing members trading while they are not fully staffed. These risk management functions would work in tandem with risk controls, including the implementation of kill switch capabilities, adopted by the exchanges operating overnight trading sessions or by clearing FCMs, as applicable.

In addition to the above, OCC would adapt existing processes so that such processes can be used to mitigate risk associated with overnight trading sessions. Specifically, OCC would exercise its authority to issue margin calls, and prevent the

withdrawal of excess margin on deposit at OCC, as a result of activity during such trading sessions as a means of reducing risk. OCC also would implement a systemic function to identify trades executed during overnight trading sessions by clearing members not approved for such trading sessions for further review prior to allowing such trades to proceed further through OCC's clearance processing, and therefore mitigate the risk of losses from erroneous trades. Finally, OCC would be able to assess the need to take protective action pursuant to OCC Rule 305 as a result of clearing member activity during such sessions.

Consistency with the Payment, Clearing and Settlement Supervision Act

OCC believes that the proposed change is consistent with Section 805(b)(1) of the Payment, Clearing and Settlement Supervision Act¹⁶ because the proposed change would promote robust risk management.¹⁷ OCC believes that the proposed changes described above would provide OCC with the tools necessary to mitigate risks that may occur as a result of overnight trading sessions. Specifically, OCC would implement risk monitoring processes designed to identify increases in credit risk presented to OCC as a result of such sessions as well as implement changes designed to mitigate operational risk associated with overnight trading sessions. In addition, OCC would adapt certain existing practices to accommodate these overnight trading sessions including its margin call process and its authority to take protective action pursuant to OCC Rule 305. These practices are designed to identify and mitigate risks that may be presented to OCC as a result of overnight trading sessions and thereby promote robust risk management.

¹⁶ 12 U.S.C. 5464(b).

¹⁷ 12 U.S.C. 5464(b)(1).

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 that the Commission receives the notice of proposed change, or (ii) the date the Commission receives any further information it requests for consideration of the notice. The clearing agency 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.

The clearing agency shall post notice on its website of proposed changes that are implemented.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed change, is consistent with the Payment, Clearing and Settlement Supervision 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-2014-812 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-2014-812. 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 am and 3:00 pm. Copies of the filing also will be available for inspection and copying at the principal office of OCC and on OCC's website

http://www.theocc.com/components/docs/legal/rules_and_bylaws/sr_occ_14_812.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-2014-812 and should be submitted on or before [insert date 15 days from publication in the Federal Register].

By the Commission.

Brent Fields
Secretary