

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-83321; File No. SR-OCC-2018-007)

May 24, 2018

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of Amendment No. 1 and Order Approving Proposed Rule Change, as Modified by Amendment No. 1, Related to The Options Clearing Corporation's Trade Acceptance and Novation Rules

On March 23, 2018, the Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("Commission"), 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> proposed rule change SR-OCC-2018-007. The proposed rule change was published for comment in the Federal Register on April 9, 2018.<sup>3</sup> The Commission did not receive any comments on the proposed rule change. On April 19, 2018, OCC filed Amendment No. 1 to the proposed rule change.<sup>4</sup> The Commission is publishing this notice to solicit comment on Amendment No. 1 from interested persons and is approving the proposed rule change, as modified by Amendment No. 1.

I. Description of the Proposed Rule Change<sup>5</sup>

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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> Securities Exchange Act Release No. 82984 (April 3, 2018), 83 FR 15181 (April 9, 2018) (SR-OCC-2018-007) ("Notice").

<sup>4</sup> OCC submitted Amendment No. 1 to correct an error in Exhibit 5B of the Notice, which did not accurately reflect the text of existing OCC Rule 2202(c) and erroneously contained proposed changes to that inaccurate text. Amendment No. 1 clarifies that the rule text for existing Rule 2202(c) would remain unchanged and would not be affected by the proposed rule change.

<sup>5</sup> The subsequent description of the proposed rule change is substantially excerpted from OCC's description in the Notice. See Notice, 83 FR 15181-15186.

OCC proposed to amend OCC's By-Laws ("By-Laws") and Rules to: (1) clarify the time at which OCC accepts and novates<sup>6</sup> the transactions that it clears; (2) streamline provisions in the By-Laws and Rules related to trade reporting and novation; and (3) delete provisions that apply only to certain dormant products that OCC no longer clears and settles or that are no longer applicable to OCC's current clearing processes.

## **Background**

### *Acceptance and Novation Timing*

Clearly stating the specific time at which OCC accepts transactions for clearance and settlement is important to Clearing Members because it signifies the time under the By-Laws and Rules at which the following events occur: (1) OCC is substituted through novation as the central counterparty ("CCP") to each Clearing Member that was an initial party to the transaction; (2) the rights of the initial Clearing Member parties to the transaction become solely as against OCC; and (3) OCC becomes obligated to each Clearing Member in accordance with the By-Laws and Rules,<sup>7</sup> including as a guarantor of the settlement obligations associated with transactions that OCC accepts and novates.<sup>8</sup>

### *Current Acceptance and Novation of Confirmed Trades*

While most trades are functionally novated upon proper submission to OCC for clearing, OCC's current By-Laws and Rules require a user to parse through a number of provisions and definitions in various locations to identify the time at which acceptance

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<sup>6</sup> In this context, novation is the process through which OCC is substituted as the buyer to the seller and the seller to the buyer for each cleared contact.

<sup>7</sup> See, e.g., Article VI, Section 5 of the By-Laws.

<sup>8</sup> See generally 15 U.S.C. 78q-1; 17 CFR 240.17Ad-22.

and novation occur. For example, the term Confirmed Trade<sup>9</sup> is defined to include all of the products for which OCC currently provides clearance and settlement services, with the exception of certain Stock Loan<sup>10</sup> transactions. A Confirmed Trade is novated upon OCC's acceptance of the trade, but acceptance is not deemed to occur until a designated Commencement Time. Commencement Time is defined differently for different products that meet the definition of a Confirmed Trade, but one section of the By-Laws (regarding OCC's obligations) generally defines it as the time at which OCC makes available to Clearing Members a Daily Position Report reflecting the Confirmed Trade.<sup>11</sup> Another section of the By-Laws (regarding the reporting of Confirmed Trades) specifies that this acceptance is subject to the condition that the Exchange or OTC Trade Source on which the transaction occurred has reported to OCC, during such times as OCC has prescribed, certain information regarding the Confirmed Trade and that such information passes OCC's initial validation checks.<sup>12</sup>

Under yet another section of the By-Laws, OCC generally has no right (other than regarding certain types of Confirmed Trades discussed below) to reject a Confirmed

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<sup>9</sup> Under the By-Laws, a Confirmed Trade is defined as "a transaction for the purchase, writing, or sale of a cleared contract, or for the closing out of a long or short position in a cleared contract, that is (i) effected on or through the facilities of an Exchange and submitted to the Corporation for clearance or (ii) affirmed through the facilities of an OTC Trade Source and submitted to the Corporation for clearance."

<sup>10</sup> See Article I, Section 1.S.(21) of the By-Laws. The term Stock Loan may refer to either a Hedge Loan that is part of OCC's Stock Loan/Hedge Program or a Market Loan that is part of OCC's Market Loan Program. Matters regarding the acceptance and novation of these products are addressed separately below.

<sup>11</sup> Article VI, Section 5 of the By-Laws. This typically occurs at the end of each business day.

<sup>12</sup> Article VI, Section 7 of the By-Laws.

Trade due to the failure of the Purchasing Clearing Member to pay any amount due to OCC at or before the settlement time.<sup>13</sup> This means that transactions in most products that are Confirmed Trades will inevitably be accepted for clearing and novated at the Commencement Time simply due to the passage of time.<sup>14</sup> OCC proposed the changes herein to reflect this reality.

*Different Commencement Times and Rejection Rights for Certain Confirmed Trades*

Certain categories of Confirmed Trades are not subject to the general Commencement Time described above, and OCC retains certain rights to reject such transactions. Specifically, Article VI, Section 5 of the By-Laws excludes the products described below from the general Commencement Time, while setting forth the following alternate definitions of Commencement Time:

(1) For futures issued in exchange-for-physical transactions,<sup>15</sup> block trades,<sup>16</sup> or other trades designated as non-competitively executed: the time after the

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<sup>13</sup> See Article VI, Section 8 of the By-Laws.

<sup>14</sup> An Exchange or OTC Trade Source, however, may instruct OCC to disregard a transaction that it previously reported as a Confirmed Trade “because of a subsequent determination that (i) the trade information submitted by the Purchasing Clearing Member and Selling Clearing Member did not agree, (ii) the trade information did not contain all the information required by the Corporation as set forth in the By-Laws and Rules, or (iii) new or revised trade information was required to properly clear the transaction.” See Article VI, Section 7 of the By-Laws. This authority would be preserved and relocated into OCC’s Rules in connection with the proposed changes described herein.

<sup>15</sup> An exchange-for-physical transaction (or “EFP”) is a transaction between two parties in which a futures contract on a commodity or security is exchanged for the actual physical good.

<sup>16</sup> A block trade is a trade involving a large number of shares being traded at an arranged price between parties, outside of the open markets, in order to lessen the impact of such a large trade being made public.

transaction is reported to OCC that OCC receives the first variation settlement payment;<sup>17</sup>

(2) For cross-rate FX options and FX index options: the time that is three hours following the settlement time of the Confirmed Trade in which such contract was purchased;<sup>18</sup> and

(3) For OTC Options (other than Backloaded OTC Options): the time when a report of OCC's acceptance is made available to Clearing Members through OCC's clearing system.<sup>19</sup>

That same section of the By-Laws specifies that, for Backloaded OTC Options, the transaction is not accepted for clearing until the Selling Clearing Member has met its regular morning settlement obligation on the business day following the reporting of the trade to OCC.<sup>20</sup>

In addition to the separate Commencement Times for these types of Confirmed Trades, OCC also currently has certain authority to reject such trades due to the failure of the Purchasing Clearing Member to pay an amount due to OCC at or before the applicable settlement time.<sup>21</sup> In contrast to most other types of Confirmed Trades, this means that OCC continues to have authority to reject these transactions even after they are properly submitted for clearing. OCC's authority to reject these types of Confirmed Trades arises under the following circumstances:

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<sup>17</sup> See Article XII, Section 7 of the By-Laws.

<sup>18</sup> See Articles XX, Section 1 and XXIII, Section 1 of the By-Laws.

<sup>19</sup> See Article VI, Section 5 of the By-Laws.

<sup>20</sup> Id.

<sup>21</sup> See generally Article VI, Section 8 of the By-Laws identifying these exceptions.

- (1) For futures issued in exchange-for-physical transactions, block trades, or other trades designated as non-competitively executed: in the event OCC fails to receive any variation payment due in the accounts of the Clearing Members;<sup>22</sup>
- (2) For cross-rate FX options and FX index options: in the event OCC fails to receive from the Purchasing Clearing Member premiums denominated in the proper trading currency in the account in which the transaction is effected;<sup>23</sup> and
- (3) For Backloaded OTC Options: in the event the Selling Clearing Member does not meet its regular morning settlement obligation on the business day following the reporting of the trade to OCC.<sup>24</sup>

### **Proposed Changes to Acceptance and Novation Rules**

#### *Proposed Uniform Acceptance and Novation Timing for Nearly All Confirmed Trades*

To provide greater certainty and clarity to Clearing Members and other interested parties regarding the acceptance and novation timing for transactions that OCC clears and settles, OCC proposed to amend the substance of Article VI, Section 5 of the By-Laws<sup>25</sup> to set forth a uniform acceptance and novation time for nearly all Confirmed Trades. As described in more detail below, OCC would retain exceptions from the uniform acceptance and novation time for Confirmed Trades in Backloaded OTC Options and

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<sup>22</sup> See Article XII, Section 7 of the By-Laws.

<sup>23</sup> See Article XX, Section 5, Article XXIII, Section 7 of the By-Laws.

<sup>24</sup> See Article VI, Section 8 of the By-Laws. In addition, OCC will not accept a Backloaded OTC Option for clearing if OCC receives it from the OTC Trade Source after 4 p.m. Central on the business day that is four business days prior to its expiration.

<sup>25</sup> As described below under the heading *Reorganization*, OCC also proposes to relocate the provisions currently in Article VI, Section 5 of the By-Laws to Rules 401 and 404.

Confirmed Trades in futures issued in exchange-for-physical transactions, block trades, or other trades designated as non-competitively executed.

To accomplish this, OCC proposed to eliminate the concept of Commencement Time and instead deem nearly all Confirmed Trades to be accepted and simultaneously novated when they are reported to OCC and the related position information has been recorded in OCC's clearing system (which occurs on a real-time basis).<sup>26</sup> This would, however, be subject to the condition that the required transaction information reported to OCC by the Exchange or OTC Trade Source first passes OCC's validation procedures<sup>27</sup> and is provided to OCC at such time as OCC prescribes. This change is intended to provide a more definitive indication of the point after which OCC no longer has authority to reject such transactions for clearing.<sup>28</sup> Eliminating the concept of Commencement Time also necessitates deleting the term from the defined terms in Article I, Section 1 of the By-Laws and replacing all references to Commencement Time with references to the time at which OCC accepts a transaction for clearing. To do this, OCC proposed to

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<sup>26</sup> OCC notes that upon acceptance and recording of position information in OCC's ENCORE clearing system, Clearing Members have the ability to see the trades they are responsible for via position information screens in the ENCORE system and through real-time messaging.

<sup>27</sup> All inbound trades to OCC are subject to coded validation of the required fields for trades. These fields contain the critical details of the trade, including but not limited to the trade source, symbol, expiration, strike, call or put, quantity, price, and Clearing Member details of both sides of the trade.

<sup>28</sup> As described above, an Exchange or OTC Trade Source would continue to have the authority to instruct OCC to disregard a Confirmed Trade. See supra 10.

amend the following provisions of its By-Laws: Article I (definition of “American; American-style”); Sections 5, 6, and 12 of Article VI;<sup>29</sup> and Section 7 of Article XII.

OCC also proposed to amend Rule 401 to clarify the trade information required to be submitted by the participant Exchange to OCC as a condition to acceptance and novation. For options transactions, amended Rule 401(a)(1)(i) would provide that these terms include: (a) the identity of the Purchasing Clearing Member and Writing Clearing Member to the transaction; (b) the clearing date; (c) the transaction time; (d) the trade source; (e) the trade quantity; (f) the trade price; (g) the security type; (h) the ticker symbol; (i) the series/contract date; (j) whether the trade is a put or a call; (k) the strike price; (l) whether the trade is a purchase or a sale; (m) the account type; (n) the allocation indicator, if applicable; (o) the CMTA indicator, if applicable; (p) the Give-Up Clearing Member, if applicable; (q) the trade type, including, in the case of futures options, whether the transaction is a block trade, exchange-for-physical, or any other trade designated by the futures market or security futures market reporting the trade as a non-competitively executed trade; (r) in the case of OTC options transactions in a securities customers’ account, a unique customer ID for the customer for whom the trade was executed; and (s) in the case of OTC options, such other variable terms as provided in Section 6 of Article XVII of the By-Laws. In addition, new Rule 401(a)(1)(ii) would

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<sup>29</sup> As described in more detail below, OCC proposes to relocate Article VI, Sections 5 and 6 to Rules 401, 404, and 405 to help streamline and reorganize provisions addressing trade reporting and novation.



provide that OCC may also request certain optional trade information that is not required as a condition for acceptance.<sup>30</sup>

For futures transactions, Rule 401(a)(2)(i) would be amended to provide that the required terms for acceptance and novation include: (a) the identity of the Purchasing Clearing Member and the Selling Clearing Member to the transaction; (b) the clearing date; (c) the transaction time; (d) the trade source; (e) the trade quantity; (f) the trade price; (g) the security type; (h) the ticker symbol; (i) the series/contract date; (j) whether the trade is a purchase or a sale; (k) the account type; (l) the allocation indicator, if applicable; (m) the CMTA indicator, if applicable; (n) the Give-Up Clearing Member, if applicable; and (o) whether the trade is an exchange-for-physical or block trade or any other trade designated by the futures market or security futures market reporting the trade as a non-competitively executed trade. In addition, new Rule 401(a)(2)(ii) would provide that OCC may also request certain optional trade information that is not required as a condition for acceptance.

Taken together, these changes are designed to provide a uniform approach for nearly all Confirmed Trades regarding acceptance and novation. OCC believes the changes will reduce the complexity of its Rules and By-Laws, while at the same time providing significantly greater clarity and transparency in OCC's legal framework for Clearing Members and other interested parties concerning the point at which OCC does not have authority to reject a transaction after it has been properly submitted to and validated by OCC. OCC believes that adopting this uniform approach regarding

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<sup>30</sup> OCC makes available to its participant Exchanges and Clearing Members the complete list of required and optional trade information in an inbound reference guide for Exchange trades.

acceptance and novation will neither functionally change the time at which OCC becomes obligated regarding Confirmed Trades nor otherwise alter the credit risk OCC faces with respect to such Confirmed Trades.

First, providing that nearly all Confirmed Trades are accepted and novated upon proper submission functionally would not change the time at which OCC becomes obligated regarding such Confirmed Trades because OCC currently has no right to reject Confirmed Trades, upon proper submission, due to the failure of a Purchasing Clearing Member to pay any amount due to OCC at or before the settlement time. Second, OCC generally does not collect margin with respect to such Confirmed Trades until 9:00 a.m. Central the following business day.<sup>31</sup> OCC, therefore, already faces this same credit risk between the acceptance of the Confirmed Trades and the time that it collects margin from Clearing Members. Accordingly, OCC does not anticipate that moving the novation time from the general Commencement Time to earlier in the day as described above – at the point of acceptance – would alter the credit risk OCC faces with respect to such Confirmed Trades. In addition, OCC would continue to have the same authority that it does today to address any credit risk as necessary through intra-day margin collection.<sup>32</sup>

Further, OCC believes that it would be appropriate to also apply the uniform acceptance and novation time to OTC Options that are not Backloaded OTC Options. OTC Options currently are subject to an alternative Commencement Time, designated for OTC Options that are not Backloaded OTC Options as the time when a report of OCC's

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<sup>31</sup> See Article I, Section 1.S.(16) of the By-Laws (defining the term “settlement time” in respect of a Clearing Member’s obligation to pay amounts owed to OCC).

<sup>32</sup> See OCC Rule 609 (addressing OCC’s authority to require intra-day margin).

acceptance is made available to Clearing Members through OCC's clearing system.<sup>33</sup> In practice, OCC automatically makes a report of its acceptance of such OTC Options available to Clearing Members in its clearing system, provided the OTC Option is properly reported to OCC, the contract passes OCC's validation process, and the contract is not rejected, all of which generally is completed immediately upon submission of the contract to OCC.<sup>34</sup> This is consistent with the new uniform approach OCC proposed, which would deem nearly all Confirmed Trades to be accepted and simultaneously novated when they are reported to OCC and the related position information has been recorded in OCC's clearing system, which occurs on a real-time basis. Accordingly, OCC believes there is no operational, risk management, or other reason to exclude OTC Options that are not Backloaded OTC Options from the proposed uniform acceptance and novation timing.

*Proposed Exceptions to the Uniform Acceptance and Novation Timing*

For other categories of Confirmed Trades that currently are not subject to the general definition of Commencement Time (i.e., Confirmed Trades in futures issued in exchange-for-physical transactions, block trades, or other trades designated as non-competitively executed), OCC proposed to preserve the existing structure under which OCC has authority to reject the transactions even after they are properly submitted for clearing by creating an exception to the uniform acceptance and novation timing for such trades. OCC believes that delayed novation continues to be appropriate for such non-

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<sup>33</sup> Article VI, Section 5 of the By-Laws.

<sup>34</sup> See Securities Exchange Act Release No. 68434 (December 14, 2012), 77 FR 75243 (December 19, 2012) (SR-OCC-2012-14 and AN-OCC-2012-01) (discussing the trade submission mechanics for OTC Options).

competitively executed transactions because there is a heightened risk that non-competitive execution may cause them to be effected at off-market prices, which could lead to significant losses if a Clearing Member defaults on the related settlement obligations.<sup>35</sup>

As proposed, an exception to the uniform acceptance and novation timing also would be made for Confirmed Trades that are Backloaded OTC Options, which are defined as OTC Options for which the premium payment date is prior to the business day on which the transaction is submitted to OCC for clearing.<sup>36</sup> OCC believes that an exception for Backloaded OTC Options remains necessary because their “backloaded” nature means that the premium payment has already been made. Backloaded OTC Options also are subject to being non-competitively executed and therefore present the same heightened settlement default risk regarding other non-competitively executed transactions discussed above. In addition, because OCC is not able to immediately validate a Backloaded OTC Options transaction or check its price reasonability upon submission, OCC believes that it remains appropriate to continue its existing practice of delaying acceptance and novation for these contracts until the selling Clearing Member

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<sup>35</sup> OCC also proposes to add new Interpretation and Policy .05 to provide that OCC will not treat an EFP or block trade as a noncompetitively executed trade subject to Article XII, Section 7 of the By-Laws if the Exchange on which such trade is executed has made representations satisfactory to OCC that the Exchange has rules, policies or procedures that require each EFP and block trade that is submitted to OCC to be executed at a reasonable price and that such price is validated by the Exchange. This new Interpretation and Policy to Rule 401 would reiterate current Interpretation and Policy .04 to Article XII, Section 7 of the By-Laws to provide additional clarity in the Rules around the acceptance and novation time for competitively executed EFPs and block trades.

<sup>36</sup> See Article I, Section 1.B.(1) of the By-Laws.

has met its regular morning settlement obligations on the business day following trade reporting.

*Provisional Information Regarding Confirmed Trades*

OCC proposed that its acceptance and novation time would no longer be tied to publication of a Daily Position Report, given that OCC's acceptance of a Confirmed Trade would instead be reflected in the position information that OCC makes available to Clearing Members throughout the business day. Accordingly, OCC proposed to amend Interpretation and Policy .01 to Rule 501 to: (1) clarify that OCC makes updated position data reflecting accepted and novated trades available to its Clearing Members throughout the day; and (2) remove from that provision a statement that Clearing Members must rely on the Daily Position Report for definitive information regarding their positions.

*Hedge Loans and Market Loans*

In addition to its clearance and settlement of Confirmed Trades, OCC also acts as a CCP for certain stock lending transactions that are part of its Stock Loan/Hedge Program and Market Loan Program. OCC proposed to amend its rules for both programs to better describe its process for accepting Hedge Loans and Market Loans and to appropriately harmonize certain provisions governing each type of Stock Loan.<sup>37</sup>

Stock Loan/Hedge Loan Program. Hedge Loans are initiated as stock lending transactions that are negotiated and settled between Clearing Members at The Depository Trust Company ("DTC") before they are reported to OCC. Rule 2202(b) provides that OCC must generally accept these stock lending transactions upon receipt of a report from

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<sup>37</sup> See OCC Rules 2202(b); 2202A(b), (c).

DTC that shows a completed transaction.<sup>38</sup> However, OCC *may* reject a transaction if it determines that it is: (1) not in accordance with OCC's By-Laws or Rules; (2) one or both account numbers specified are invalid for Hedge Loans; or (3) the information provided by DTC contains errors or omissions. Moreover, Rule 2202(b) provides that if OCC does not affirmatively reject a reported transaction by such a time as OCC is authorized to specify from time to time then the transaction is deemed accepted as a Hedge Loan. Upon acceptance, OCC becomes the lender to the Borrowing Clearing Member and the borrower to the Lending Clearing Member. Although OCC has discretion during each business day to make provisional information available to Clearing Members regarding their lending and borrowing activity, only the Stock Loan Mark to Market Activity Report is recognized as providing definitive Hedge Loan positions.<sup>39</sup>

OCC proposed to amend Rule 2202(b) to clarify that OCC receives and accepts completed transaction information from DTC throughout the day, and it would delete the statement that a transaction is deemed accepted by a particular cut off time if OCC does not affirmatively notify Clearing Members of a rejection. Rule 2202(b) would instead state that OCC generally accepts completed transactions reported to it unless: (1) OCC is otherwise required to reject a transaction because it is not in accordance with the By-Laws or Rules; (2) one or both account numbers specified are invalid; or (3) the information provided contains unresolved errors or omissions. OCC believes that these changes will help clarify the time at which Hedge Loans are accepted and the specific circumstances in which Hedge Loans will be rejected. As discussed more fully below,

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<sup>38</sup> OCC is not obligated to accept the stock lending transactions of a Clearing Member that has been suspended by DTC. See OCC Rule 2210(a). The same condition applies regarding Market Loans. See OCC Rule 2210A(a).

<sup>39</sup> See Rule 2202, Interpretation and Policy .01.

the change also would ensure consistency between parallel provisions in the Stock Loan/Hedge Program and Market Loan Program regarding the initiation process, which OCC believes should apply equally across both programs. Finally, a reference to the Stock Loan Mark to Market Activity Report being the only definitive statement of positions would be deleted because Hedge Loan positions would be definitive upon acceptance in OCC's clearing system.

Market Loan Program. In connection with the Market Loan Program initiation process, DTC also sends information to OCC regarding completed stock lending transactions. Rule 2202A(b) provides that, upon OCC's receipt of an end of day stock loan activity file from DTC, OCC must accept the transactions as Market Loans unless it is required to reject them for the same reasons described above concerning Hedge Loans. The Rule further provides that, upon OCC's affirmative acceptance, OCC becomes the lender to the Borrowing Clearing Member and the borrower to the Lending Clearing Member.

As with the proposed changes to the Stock Loan Hedge Program, OCC proposed to clarify that OCC receives and accepts completed transaction information from DTC throughout the day. OCC also proposed to delete a reference to affirmative acceptance in Rule 2202A(b) because the other proposed changes would clarify that acceptance will generally take place automatically unless OCC is specifically required to reject transactions due to the deficiencies described above. A conforming change also would be made in this regard in Rule 2202A(c). References to the definitive nature of the Stock Loan Mark to Market Activity Report would be deleted for the same reasons described above regarding Hedge Loans.

### *Streamlining and Reorganization*

As part of its continued effort to streamline its By-Laws and Rules, OCC proposed to relocate certain provisions from Article VI, Sections 4 through 8 of the By-Laws to Chapter IV of the Rules. This change would promote a centralized location for provisions that address trade reporting and novation. OCC also proposed to consolidate certain provisions in Chapter IV of the Rules to eliminate redundancy. These proposed organizational changes are summarized below.

OCC would relocate Article VI, Section 4 of OCC's By-Laws regarding a Purchasing Clearing Member's obligations with respect to a Confirmed Trade, without amendment, to a new Rule 403. As described above, OCC would amend Article VI, Section 5 of the By-Laws regarding OCC's obligations with respect to a Confirmed Trade, and it would be incorporated into existing Rule 401 and new Rule 404. As described above, OCC would amend Article VI, Section 6 of the By-Laws regarding the issuance of cleared contracts, and it would be relocated to a new Rule 405. OCC would relocate Article VI, Section 7 of the By-Laws regarding the reporting of confirmed trades incorporate it into Rule 401. More specifically, Article VI, Section 7(b) of the By-Laws would become Rule 401(e), Section 7(c) would become Rule 401(f), and Interpretation and Policy .01 to Section 7 would become Interpretation and Policy .03 to Rule 401. As described above, OCC would amend Article VI, Section 8 of the By-Laws regarding payments made to OCC and relocate it to new Rule 406. To accommodate these new rules in Chapter IV, current Rule 403 would be renumbered as 407, and current Rule 405 would be renumbered as Rule 408. Cross-references also would be updated to reflect this renumbering throughout Chapter IV of the Rules, as well as in Article I, Section 1.G.(3)



and (4), Article VI, Section 2, and Article XVII, Sections 2(a) and 2(c)(1) of the By-Laws, and Rules 504(e), 504(g), and 611(a).

Additionally, to create a more centralized trade reporting rule, OCC proposed to delete existing Rule 404 regarding the reporting of confirmed trades in OTC Options and to incorporate its substance into Rule 401. This would require the addition of references to OTC Trade Sources in Rule 401(a) and (b), and the merger of language from Rule 404(b) into Rule 401(b) and from Rule 404(c) into Rule 401(d).

#### *Elimination of Dormant Products and Rules*

OCC no longer clears and settles cross-rate foreign currency options and flexibly-structured index options denominated in a foreign currency. Accordingly, OCC proposed to delete certain provisions from its By-Laws and Rules that only apply to such products. When OCC still actively cleared and settled these products they were subject to delayed novation. OCC therefore believes that eliminating the rules governing these products at this time would avoid confusion and enhance clarity regarding OCC's proposed uniform approach to trade acceptance and novation timing. Consequently, OCC proposed to delete Articles XX and XXIII of its By-Laws, which governs cross-rate foreign currency options, and Chapters XXI and XXIV of its Rules, which govern flexibly-structured index options denominated in a foreign currency. Additionally, OCC proposed to eliminate all other references to such products throughout its By-Laws and Rules, including in Section 1(d) of Article V, and Interpretation and Policy .03 to Section 1 of Article V of the By-Laws and Rules 607, 1107(a)(3) and 1107(a)(4), as well as in the definitions of Option Contract, Trading Currency, and Underlying Currency in Article I of the By-Laws.

OCC also proposed to delete Rule 402 concerning the supplementary reporting of Confirmed Trades. Rule 402 grants OCC the discretion to, in certain extraordinary circumstances, accept from an Exchange after the cut-off time for receiving Confirmed Trade information for a particular business day (“trade date”), supplementary Confirmed Trade information reflecting the comparison of additional trades executed on or before the trade date that remained unconfirmed at the cut-off time. Rule 402 was adopted at a time when OCC received matched trade information from Exchanges for a given trade date in a single batch submission after the close of the trading day.<sup>40</sup> Under this old process, trades that remained unmatched when an Exchange prepared its nightly trade tape to OCC were omitted from the tape and, if a trade was subsequently matched, the Exchange reported the trade to OCC the following night to be processed as if it had not been executed until the date when it was reported. OCC adopted Rule 402 to accommodate the late submission of trades that had not been matched in time to be submitted on the Exchange’s original trade tape, thereby allowing those trades to be processed as if they were submitted on their original trade date. OCC proposed to delete Rule 402 because it is no longer applicable to OCC’s current clearing processes, whereby OCC continuously receives matched trade information from Exchanges on a real-time basis.

## II. Discussion and Commission Findings

Section 19(b)(2)(C) of the Act directs the Commission to approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is

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<sup>40</sup> See Filing and Order Granting Accelerated Approval of Proposed Rule Change of Options Clearing Corporation, Securities Exchange Act Release No. 21233 (August 10, 1984) (SR-OCC-84-12).

consistent with the requirements of the Act and the rules and regulations thereunder applicable to such organization.<sup>41</sup> After carefully considering the proposed rule change, the Commission believes that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to OCC. More specifically, the Commission believes that the proposal is consistent with Section 17A(b)(3)(F) of the Act<sup>42</sup> and Rule 17Ad-22(e)(1) under the Act.<sup>43</sup>

A. Consistency with Section 17A(b)(3)(F) of the Act

Section 17A(b)(3)(F) of the Act<sup>44</sup> requires, among other things, that the rules of a clearing agency be designed to foster cooperation and coordination with persons engaged in the clearance and settlement of securities transactions, promote the prompt and accurate clearance and settlement of securities and derivatives transactions, and, in general, protect investors and the public interest. As described above, the proposed rule change is intended to provide a clear and uniform acceptance and novation time for nearly all Confirmed Trades and to clarify the acceptance and novation timing regarding Stock Loans by specifying the time at which novation occurs and when Confirmed Trades and Stock Loans may no longer be rejected by OCC. Under the proposed uniform acceptance time, OCC would deem nearly all Confirmed Trades to be accepted and simultaneously novated when they are reported to OCC, provided that the transaction information reported to OCC passes OCC's validation procedures and is provided to OCC at such time as OCC's rules prescribe. In addition, the proposed rule change would

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<sup>41</sup> 15 U.S.C. 78s(b)(2)(C).

<sup>42</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>43</sup> 17 CFR 240.17Ad-22(e)(1).

<sup>44</sup> 15 U.S.C. 78q-1(b)(3)(F).

eliminate certain dormant rules no longer applicable to OCC's clearance and settlement services and processes.

The Commission believes that these changes would provide greater clarity and transparency to Clearing Members, other users of OCC, and the general public regarding OCC's processes for the reporting of transactions, acceptance, and novation. Instead of parsing through multiple different definitions and provisions in various locations throughout OCC's By-Laws and Rules to identify the different times at which acceptance and novation occurs for different transactions, users and other interested parties will be able to refer to more uniform approach set forth in a single chapter of OCC's Rules. This, in turn, will help avoid potential confusion and ambiguity. Accordingly, the Commission believes that, taken together, these changes will help foster cooperation and coordination with persons engaged in the clearance and settlement of securities transactions, promote the prompt and accurate clearance and settlement of securities and derivatives transactions, and, in general, protect investors and the public interest consistent with Section 17A(b)(3)(F) of the Act.<sup>45</sup>

B. Consistency with Rule 17Ad-22(e)(1)

Rule 17Ad-22(e)(1)<sup>46</sup> requires a covered clearing agency to 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. The Commission believes the proposed changes are consistent with Rule 17Ad-22(e)(1) for the reasons set forth below.

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<sup>45</sup> Id.

<sup>46</sup> 17 CFR 240.17Ad-22(e)(1).

First, by modifying the current process so that all Confirmed Trades, subject to limited exceptions, would be deemed accepted and simultaneously novated when they are reported to OCC and the related position information has been recorded in OCC's clearing system, the proposed rule change would provide a clear and uniform time regarding OCC's acceptance and novation for nearly all Confirmed Trades and clarify OCC's acceptance and novation process regarding Stock Loans. The Commission believes this would bring clarity and transparency to OCC's By-Laws and Rulebook and help simplify the process of reporting transactions, acceptance, and novation, which in turn will help ensure that OCC has a well-founded, clear, transparent, and enforceable legal basis regarding the rights and obligations of OCC and Clearing Members regarding Confirmed Trades, consistent with Rule 17Ad-22(e)(1).

Second, the Commission believes that the streamlining and reorganizing all of the provisions concerning transaction reporting, acceptance, and novation and consolidating them in Chapter IV of the Rules would promote consistency and readability and help avoid potential confusion and ambiguity, and therefore allow the provisions to be more easily understood. For example, enumerating the trade information required to be submitted by participant Exchanges to OCC for options and futures transactions would allow for greater clarity of the information required and that may be requested by OCC. Similarly, by better describing the process by which Hedge Loans and Market Loans are accepted, OCC would harmonize the relevant provisions of its Rulebook governing each type of Stock Loan. In addition, the Commission believes eliminating provisions related to processes no longer supported by OCC and dormant products that are no longer cleared and settled by OCC would improve the clarity and transparency of its By-Laws

and Rules. Accordingly, the Commission believes that the changes proposed in the proposed rule change are consistent with Rule 17Ad-22(e)(1) under the Act.<sup>47</sup>

### III. Solicitation of Comments on Amendment No. 1

Interested persons are invited to submit written data, views and arguments concerning whether Amendment No. 1, 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-2018-007 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-2018-007. 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

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<sup>47</sup>

Id.

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 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-2018-007 and should be submitted on or before [insert date 15 days from publication in the Federal Register].

#### IV. Approval of Proposed Rule Change, as Modified by Amendment No. 1

As discussed above, OCC submitted Amendment No. 1 to accurately reflect existing Rule 2202(c), which would not be affected by the proposed rule change. The Commission believes that Amendment No. 1 does not raise any novel issues or alter the proposed changes in any way. In addition, the Commission finds that the proposed rule change, as modified by Amendment No. 1, is consistent with Act and applicable rules thereunder for the reasons discussed above. Accordingly, the Commission finds good cause to approve the proposed rule change, as modified by Amendment No. 1 pursuant to Section 19(b)(2) of the Act.<sup>48</sup>

#### V. Conclusion

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<sup>48</sup> 15 U.S.C. 78s(b)(2).

On the basis of the foregoing, the Commission finds that the proposed rule change, as modified by Amendment No. 1, is consistent with the requirements of the Act, in particular with the requirements of Section 17A of the Act<sup>49</sup> and Rule 17Ad-22(e)(1) thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2)<sup>50</sup> of the Act, that the proposed rule change (SR-OCC-2018-007) be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>51</sup>

Eduardo A. Aleman  
Assistant Secretary

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<sup>49</sup> In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>50</sup> 15 U.S.C. 78s(b)(2).

<sup>51</sup> 17 CFR 200.30-3(a)(12).