



June 6, 2017

**VIA ELECTRONIC MAIL**

Christopher J. Kirkpatrick  
Office of the Secretariat  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21<sup>st</sup> Street, N.W.  
Washington, DC 20581

**Re: Rule Filing SR-OCC-2017-013 Rule Certification**

Dear Secretary Kirkpatrick:

Pursuant to Section 5c(c)(1) of the Commodity Exchange Act, as amended (“Act”), and Commodity Futures Trading Commission (“CFTC”) Regulation 40.6, enclosed is a copy of the above-referenced rule filing submitted by The Options Clearing Corporation (“OCC”). The date of implementation of the rule is at least 10 business days following receipt of the rule filing by the CFTC or the date the proposed rule is approved by the Securities and Exchange Commission (“SEC”) or otherwise becomes effective under the Securities Exchange Act of 1934 (the “Exchange Act”). This rule filing has been, or is concurrently being, submitted to the SEC under the Exchange Act.

OCC has requested confidential treatment for Exhibit 5C to SR-OCC-2017-013, the Stock Options and Futures Settlement Agreement, contained in pages 83-97 of the enclosed filing.

In conformity with the requirements of Regulation 40.6(a)(7), OCC states the following:

**Explanation and Analysis**

This proposed rule change by OCC concerns a new Stock Options and Futures Settlement Agreement (“New Accord”) between OCC and the National Securities Clearing Corporation (“NSCC,” collectively NSCC and OCC may be referred to herein as the “clearing agencies”) and amendments to OCC’s By-Laws and Rules to accommodate the proposed provisions of the New Accord.

The proposed changes to OCC’s By-Laws and Rules and the proposed New Accord are included as Exhibits 5A - 5C, respectively.<sup>1</sup> Material proposed to be added to OCC’s By-Laws

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<sup>1</sup> OCC has filed an advance notice with the SEC in connection with the New Accord. See SR-

and Rules as currently in effect is marked by underlining and material proposed to be deleted is marked by strikethrough text. With respect to the New Accord, underlining and strikethrough text have been omitted to enhance readability due to the significance of the proposed changes, both in terms of substance and quantity. All terms with initial capitalization that are not otherwise defined herein have the same meaning as set forth in the OCC By-Laws and Rules.<sup>2</sup>

## Background

OCC issues and clears U.S.-listed options and futures on a number of underlying financial assets including common stocks, currencies and stock indices. OCC's Rules, however, provide that delivery of, and payment for, securities underlying certain physically settled stock options and single stock futures cleared by OCC are effected through the facilities of a correspondent clearing corporation (i.e., NSCC) and are not settled through the facilities OCC. OCC and NSCC are parties to a Third Amended and Restated Options Exercise Settlement Agreement, dated February 16, 1995, as amended ("Existing Accord"),<sup>3</sup> which governs the delivery and receipt of stock in the settlement of put and call options issued by OCC ("Stock Options") that are eligible for settlement through NSCC's Continuous Net Settlement ("CNS") Accounting Operation and are designated to settle on the third business day following the date the related exercise or assignment was accepted by NSCC ("Options E&A"). All OCC Clearing Members that intend to engage in Stock Options transactions are required to also be Members of NSCC or to have appointed or nominated an NSCC Member to act on its behalf.<sup>4</sup>

OCC proposes to adopt a New Accord with NSCC, which would provide for the settlement of certain Stock Options and delivery obligations arising from certain matured physically-settled stock futures contracts cleared by OCC ("Stock Futures"). Specifically, the New Accord would, among other things: (1) expand the category of securities that are eligible for settlement and guaranty under the agreement to certain securities (including stocks,

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OCC-2017-804. NSCC also has filed proposed rule change and advance notice filings with the SEC in connection with the New Accord. See NSCC filings SR-NSCC-2017-007 and SR-NSCC-2017-803, respectively.

<sup>2</sup> OCC's By-Laws and Rules can be found on OCC's public website: <http://optionsclearing.com/about/publications/bylaws.jsp>. Other terms not defined herein or in the OCC By-Laws and Rules can be found in the Rules & Procedures of NSCC ("NSCC Rules"), available at [http://www.dtcc.com/~media/Files/Downloads/legal/rules/nsccl\\_rules.pdf](http://www.dtcc.com/~media/Files/Downloads/legal/rules/nsccl_rules.pdf), as the context implies.

<sup>3</sup> The Existing Accord and the proposed changes thereunder were previously self-certified with the CFTC (most recently, Amendment No. 2 to the Third Amended and Restated Options Exercise Settlement Agreement dated as of February 16, 1995, which was certified on November 17, 2008).

<sup>4</sup> A firm that is both an OCC Clearing Member and an NSCC Member, or is an OCC Clearing Member that has designated an NSCC Member to act on its behalf is referred to herein as a "Common Member."

exchange-traded funds and exchange-traded notes) that (i) are required to be delivered in the exercise and assignment of Stock Options and are eligible to be settled through NSCC's Balance Order Accounting Operation (in addition to its CNS Accounting Operation) or (ii) are delivery obligations arising from Stock Futures that have reached maturity and are eligible to be settled through NSCC's CNS Accounting Operation or Balance Order Accounting Operation; (2) modify the time of the transfer of responsibilities from OCC to NSCC and, specifically, when OCC's guaranty obligations under OCC's By-Laws and Rules with respect to such transactions ("OCC's Guaranty") end and NSCC's obligations under Addendum K of the NSCC Rules with respect to such transactions ("NSCC's Guaranty") begin (such transfer being the "Guaranty Substitution"); and (3) put additional arrangements into place concerning the procedures, information sharing, and overall governance processes under the agreement. Furthermore, OCC proposes to make certain clarifying and conforming changes to the OCC By-Laws and Rules as necessary to implement the New Accord.

The primary purpose of the proposed changes is to (1) provide consistent treatment across all expiries for products with "regular way"<sup>5</sup> settlement cycle specifications; (2) reduce the operational complexities of the Existing Accord by eliminating the cross-guaranty between OCC and NSCC and the bifurcated risk management of exercised and assigned transactions between the two clearing agencies by delineating a single point in time at which OCC's Guaranty ceases and NSCC's Guaranty begins; (3) further solidify the roles and responsibilities of OCC and NSCC in the event of a default of a Common Member at either or both clearing agencies; and (4) improve procedures, information sharing, and overall governance under the agreement.

The New Accord would become effective, and wholly replace the Existing Accord, at a date specified in a service level agreement to be entered into between NSCC and OCC.<sup>6</sup>

## The Existing Accord

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<sup>5</sup> Under the New Accord, "regular way settlement" shall have a meaning agreed to by the clearing agencies. Generally, regular way settlement is understood to be the financial services industry's standard settlement cycle. Currently, regular way settlement of Stock Options or Stock Futures transactions are those transactions designated to settle on the third business day following the date the related exercise, assignment or delivery obligation was accepted by NSCC. NSCC has proposed to change the NSCC Rules with respect to the meaning of regular way settlement in order to be consistent with the anticipated industry-wide move to a shorter standard settlement cycle of two business days after trade date. See Securities Exchange Act Release No. 79734 (January 4, 2017), 82 FR 3030 (January 10, 2017) (SR-NSCC-2016-007). See also Securities Exchange Act Release No. 78962 (September 28, 2016), 81 FR 69240 (October 5, 2016) (S7-22-16) (Amendment to Securities Transaction Settlement Cycle).

<sup>6</sup> Such effective date would be a date following approval of all required regulatory submissions to be filed by OCC and NSCC with the appropriate regulatory authorities, including this proposed rule change. See supra note 1.

*Key Terms of the Existing Accord*

Under the Existing Accord, the settlement of Options E&A generally proceeds according to the following sequence of events. NSCC maintains and delivers to OCC a list (“CNS Eligibility Master File”) that enumerates all CNS Securities, which are defined in NSCC’s Rule 1 and generally include securities that have been designated by NSCC as eligible for processing through NSCC’s CNS Accounting Operation and eligible for book entry delivery at NSCC’s affiliate, The Depository Trust Company (for purposes of this proposed rule change, such securities are referred to as “CNS Eligible Securities”).<sup>7</sup> OCC, in turn, uses this file to make a final determination of which securities NSCC would not accept and therefore would need to be settled on a broker-to-broker basis. OCC then sends to NSCC a transactions file,<sup>8</sup> listing the specific securities that are to be delivered and received in settlement of an Options E&A that have not previously been reported to NSCC and for which settlement is to be made through NSCC (“OCC Transactions File”).<sup>9</sup> With respect to each Options E&A, the OCC Transactions File includes the CUSIP number of the security to be delivered, the identities of the delivering and receiving Common Members, the quantity to be delivered, the total value of the quantity to be delivered based on the exercise price of the option for which such security is the underlying security, and the exercise settlement date. After receiving the OCC Transactions File, NSCC then has until 11:00 AM Central Time on the following business day to reject any transaction listed in the OCC Transactions File. NSCC can reject a transaction if the security to be delivered has not been listed as a CNS Eligible Security in the CNS Eligible Master File or if information provided in the OCC Transactions File is incomplete. Otherwise, if NSCC does not so notify OCC of its rejection of an Options E&A by the time required under the Existing Accord, NSCC will become unconditionally obligated to effect settlement of the Options E&A.

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<sup>7</sup> See supra note 2.

<sup>8</sup> Delivery of the OCC Transactions File with respect to an Options E&A typically happens on the date of the option’s exercise or expiration, though this is not expressly stated in the Existing Accord. In theory, however, an Options E&A could, due to an error or delay, be reported later than the date of the option’s exercise or expiration.

<sup>9</sup> This process would be substantially the same under the New Accord with the exception that the CNS Eligibility Master File and OCC Transactions File would be renamed and would be expanded in scope to include additional securities that would be eligible for guaranty and settlement under the New Accord, as discussed in further detail below.

Under the Existing Accord, even after NSCC's trade guarantee has come into effect,<sup>10</sup> OCC is not released from its guarantee with respect to the Options E&A until certain deadlines<sup>11</sup> have passed on the first business day following the scheduled settlement date without NSCC notifying OCC that the relevant Common Member has failed to meet an obligation to NSCC or NSCC has ceased to act for such Common Member pursuant to the NSCC Rules.<sup>12</sup> As a result, there is a period of time when NSCC's trade guarantee overlaps with OCC's guarantee and where both clearing agencies are holding margin against the same Options E&A position.

In the event that NSCC or OCC ceases to act on behalf of or suspends a Common Member, that Common Member becomes a "defaulting member." Once a Common Member becomes a defaulting member, the Existing Accord provides that NSCC will make a payment to OCC equal to the lesser of OCC's loss or the positive mark-to-market amount relating to the defaulting member's Options E&A and that OCC will make a payment to NSCC equal to the lesser of NSCC's loss or the negative mark-to-market amount relating to the defaulting member's Options E&A to compensate for potential losses incurred in connection with the default. A clearing agency must request the transfer of any such payments by the close of business on the tenth business day following the day of default and, after a request is made, the other clearing agency is required to make payment within five business days of the request.

## **The New Accord**

### *Overview*

As noted above, NSCC proposes to adopt a New Accord with OCC, which would provide for the settlement of certain Stock Options and Stock Futures transactions. The New Accord is primarily designed to, among other things, expand the category of securities that are eligible for settlement and guaranty under the agreement; simplify the time of the transfer of responsibilities from OCC to NSCC (specifically, the transfer of guarantee obligations); and put additional arrangements into place concerning the procedures, information sharing, and overall governance processes under the agreement. The material provisions of the New Accord are described in detail below.

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<sup>10</sup> Pursuant to Addendum K of the NSCC Rules, NSCC guarantees the completion of CNS transactions and balance order transactions that have reached the point at which, for bi-lateral submissions by Members, such trades have been validated and compared by NSCC, and for locked-in submission, such trades have been validated by NSCC, as described in the NSCC Rules. Transactions that are covered by the Existing Accord, and that would be covered by the New Accord, are expressly excluded from the timeframes described in Addendum K. See supra note 2.

<sup>11</sup> The deadline is 6:00 AM Central Time for NSCC notifying OCC of a Common Member failure and, if NSCC does not immediately cease to act for such defaulting Common Member, 4:00 PM Central Time for notifying OCC that it has ceased to act.

<sup>12</sup> See NSCC Rule 46 (Rule 46 (Restrictions on Access to Services)). See supra note 2.

*Key Elements of the New Accord*

Expanded Scope of Eligible Securities

Pursuant to the proposed New Accord, on each day that both OCC and NSCC are open for accepting trades for clearing (“Activity Date”), NSCC would deliver to OCC an “Eligibility Master File,” which would identify the securities, including stocks, exchange-traded funds and exchange-traded notes, that are (1) eligible to settle through NSCC’s CNS Accounting Operation (as is currently the case under the Existing Accord) or NSCC’s Balance Order Accounting Operation (which is a feature of the New Accord) and (2) to be delivered in settlement of (i) exercises and assignments of Stock Options (as is currently the case under the Existing Accord) or (ii) delivery obligations arising from maturing physically settled Stock Futures (which is a feature of the New Accord) (all such securities collectively being “Eligible Securities”). OCC, in turn, would deliver to NSCC its file of E&A/Delivery Transactions<sup>13</sup> that list the Eligible Securities to be delivered, or received, and for which settlement is proposed to be made through NSCC on that Activity Date. Guaranty Substitution (discussed further below) would not occur with respect to an E&A/Delivery Transaction that is not submitted in the proper format or that involves a security that is not identified as an Eligible Security on the then-current Eligibility Master File. This process is similar to the current process under the Existing Accord with the exception of the expanded scope of Eligible Securities (and additional fields necessary to accommodate such securities) that would be listed on the Eligibility Master File and the E&A/Delivery Transactions file.

Like the Existing Accord, the proposed New Accord would continue to facilitate the processes by which Common Members deliver and receive stock in the settlement of Stock Options that are eligible to settle through NSCC’s CNS Accounting Operation and are designated to settle regular way. The New Accord would also expand the category of securities eligible for settlement under the agreement. In particular, the New Accord would facilitate the processes by which Common Members deliver and receive stock in settlement of Stock Futures that are eligible to settle through NSCC’s CNS Accounting Operation and are designated to settle regular way. It would also provide for the settlement of both Stock Options and Stock Futures that are eligible to settle through NSCC’s Balance Order Accounting Operation on a regular way basis. The primary purpose of expanding the category of securities that are eligible for settlement and guaranty under the agreement is to provide consistent treatment across all expiries

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<sup>13</sup> “E&A/Delivery Transactions” are transactions involving the settlement of Stock Options and Stock Futures under the New Accord. The delivery of E&A/Delivery Transactions to NSCC would replace the delivery of the “OCC Transactions File” from the Existing Accord. The actual information delivered by OCC to NSCC would be the same as is currently provided on the OCC Transactions File, but certain additional terms would be included to accommodate the inclusion of Stock Futures, along with information regarding the date that the instruction to NSCC was originally created and the E&A/Delivery Transaction’s designated settlement date.

for products with regular way settlement cycle specifications and simplify the settlement process for these additional securities transactions.

The New Accord would not apply to Stock Options or Stock Futures that are designated to settle on a shorter timeframe than the regular way settlement timeframe. These Stock Options would continue to be processed and settled as they would be today, outside of the New Accord. The New Accord also would not apply to any Stock Options or Stock Futures that are neither CNS Securities nor Balance Order Securities.<sup>14</sup> Transactions in these securities are, and would continue to be, processed on a trade-for-trade basis away from NSCC's facilities. Such transactions may utilize other NSCC services for which they are eligible, but would not be subject to the New Accord.<sup>15</sup>

#### Proposed Changes Related to Guaranty Substitution

The New Accord would adopt a fundamentally different approach to the delineation of the rights and responsibilities of OCC and NSCC with respect to E&A/Delivery Transactions. The purpose of the proposed changes related to the Guaranty Substitution, defined below, is to reduce the operational complexities of the Existing Accord by eliminating the cross-guaranty between OCC and NSCC and the bifurcated risk management of exercised and assigned transactions between the two clearing agencies and delineating a single point in time at which OCC's Guaranty ceases and NSCC's Guaranty begins. Moreover, the proposed changes would solidify the roles and responsibilities of OCC and NSCC in the event of a default of a Common Member at either or both clearing agencies.

As described above, the Existing Accord provides that NSCC will make a payment to OCC following the default of a Common Member in an amount equal to the lesser of OCC's loss or the positive mark-to-market amount relating to the Common Member's Options E&A, and provides that OCC will make a payment to NSCC following the default of a Common Member equal to the lesser of NSCC's loss or the negative mark-to-market amount relating to the Common Member's Options E&A to compensate for potential losses incurred in connection with the Common Member's default. The proposed New Accord, in contrast, would focus on the transfer of responsibilities from OCC to NSCC and, specifically, the point at which OCC's Guaranty ends and NSCC's Guaranty begins (i.e., the Guaranty Substitution) with respect to E&A/Delivery Transactions. By focusing on the timing of the Guaranty Substitution, rather than payment from one clearing agency to the other, the New Accord would simplify the agreement and the procedures for situations involving the default of a Common Member. The New Accord additionally would minimize "double-margining" situations when a Common Member may

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<sup>14</sup> Balance Order Securities are defined in NSCC Rule 1, and are generally securities, other than foreign securities, that are eligible to be cleared at NSCC but are not eligible for processing through the CNS Accounting Operation. See supra note 2.

<sup>15</sup> OCC will continue to guarantee settlement until settlement actually occurs with respect to these Stock Options and Stock Futures.

simultaneously owe margin to both NSCC and OCC with respect to the same E&A/Delivery Transaction.

After NSCC has received an E&A/Delivery Transaction, the Guaranty Substitution would normally occur when NSCC has received all Required Deposits to its Clearing Fund, calculated taking into account such E&A/Delivery Transaction, of Common Members (“Guaranty Substitution Time”).<sup>16</sup> At the Guaranty Substitution Time, NSCC’s Guaranty takes effect, and OCC does not retain any settlement obligations with respect to such E&A/Delivery Transactions. The Guaranty Substitution would not occur, however, with respect to any E&A/Delivery Transaction if NSCC has rejected such E&A/Delivery Transaction due to an improper submission, as described above, or if, during the time after NSCC’s receipt of the E&A/Delivery Transaction but prior to the Guaranty Substitution Time, a Common Member involved in the E&A/Delivery Transaction has defaulted on its obligations to NSCC by failing to meet its Clearing Fund obligations, or NSCC has otherwise ceased to act for such Common Member pursuant to the NSCC Rules (in either case, such Common Member becomes a “Defaulting NSCC Member”).

NSCC would be required to promptly notify OCC if a Common Member becomes a Defaulting NSCC Member, as described above. Upon receiving such a notice, OCC would not submit to NSCC any further E&A/Delivery Transactions involving the Defaulting NSCC Member for settlement, unless authorized representatives of both OCC and NSCC otherwise consent. OCC would, however, deliver to NSCC a list of all E&A/Delivery Transactions that have already been submitted to NSCC and that involve the Defaulting NSCC Member (“Defaulted NSCC Member Transactions”). The Guaranty Substitution ordinarily would not occur with respect to any Defaulted NSCC Member Transactions, unless both clearing agencies agree otherwise. As such, NSCC would have no obligation to guaranty such Defaulted NSCC Member Transactions, and OCC would continue to be responsible for effecting the settlement of such Defaulted NSCC Member Transactions pursuant to OCC’s By-Laws and Rules. Once NSCC has confirmed the list of Defaulted NSCC Member Transactions, Guaranty Substitution would occur for all E&A/Delivery Transactions for that Activity Date that are not included on such list. NSCC would be required to promptly notify OCC upon the occurrence of the Guaranty Substitution Time on each Activity Date.

If OCC suspends a Common Member after NSCC has received the E&A/Delivery Transactions but before the Guaranty Substitution has occurred, and that Common Member has not become a Defaulting NSCC Member, the Guaranty Substitution would proceed at the Guaranty Substitution Time. In such a scenario, OCC would continue to be responsible for guaranteeing the settlement of the E&A/Delivery Transactions in question until the Guaranty Substitution Time, at which time the responsibility would transfer to NSCC. If, however, the

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<sup>16</sup> Procedure XV of the NSCC Rules provides that all Clearing Fund requirements and other deposits must be made within one hour of demand, unless NSCC determines otherwise. See supra note 2.



suspended Common Member also becomes a Defaulting NSCC Member after NSCC has received the E&A/Delivery Transactions but before the Guaranty Substitution has occurred, Guaranty Substitution would not occur, and OCC would continue to be responsible for effecting the settlement of such Defaulted NSCC Member Transactions pursuant to OCC's By-Laws and Rules (unless both clearing agencies agree otherwise).

Finally, the New Accord also would provide for the consistent treatment of all exercise and assignment activity under the agreement. Under the Existing Accord, "standard"<sup>17</sup> option contracts become guaranteed by NSCC when the Common Member meets its morning Clearing Fund Required Deposit at NSCC while "non-standard" exercise and assignment activity becomes guaranteed by NSCC at midnight of the day after trade date (T+1). Under the New Accord, all exercise and assignment activity for Eligible Securities would be guaranteed by NSCC as of the Guaranty Substitution Time, under the circumstances described above, further simplifying the framework for the settlement of such contracts.

#### *Other Terms of the New Accord*

The New Accord also would include a number of other provisions intended to either generally maintain certain terms of the Existing Accord or improve the procedures, information sharing, and overall governance process under the new agreement. Many of these terms are additions to or improvements upon the terms of the Existing Accord.

Under the proposed New Accord, OCC and NSCC would agree to address the specifics regarding the time, form and manner of various required notifications and actions in a separate service level agreement which the parties would be able to revisit as their operational needs evolve. The service level agreement would also specify an effective date for the New Accord, which, as mentioned above, would occur on a date following approval and effectiveness of all required regulatory submissions to be filed by OCC and NSCC with the appropriate regulatory authorities. Similar to the Existing Accord, the proposed New Accord would remain in effect (a) until it is terminated by the mutual written agreement of OCC and NSCC, (b) until it is unilaterally terminated by either clearing agency upon one year's written notice (as opposed to six months under the Existing Accord), or (c) until it is terminated by either NSCC or OCC upon the bankruptcy or insolvency of the other, provided that the election to terminate is communicated to the other party within three business days by written notice.

Under the proposed New Accord, NSCC would agree to notify OCC if NSCC ceases to act for a Common Member pursuant to the NSCC Rules no later than the earlier of NSCC's provision of notice of such action to the governmental authorities or notice to other NSCC Members. Furthermore, if an NSCC Member for which NSCC has not yet ceased to act fails to satisfy its Clearing Fund obligations to NSCC, NSCC would be required to notify OCC promptly

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<sup>17</sup> Option contracts with "standard" expirations expire on the third Friday of the specified expiration month, while "non-standard" contracts expire on other days of the expiration month.

after discovery of the failure. Likewise, OCC would be required to notify NSCC of the suspension of a Common Member no later than the earlier of OCC's provision of notice to the governmental authorities or other OCC Clearing Members.

Under the Existing Accord, NSCC and OCC agree to share certain reports and information regarding settlement activity and obligations under the agreement. The New Accord would enhance this information sharing between the clearing agencies. Specifically, NSCC and OCC would agree to share certain information, including general risk management due diligence regarding Common Members, lists of Common Members, and information regarding the amounts of Common Members' margin and settlement obligations at OCC or Clearing Fund Required Deposits at NSCC. NSCC and OCC would also be required to provide the other clearing agency with any other information that the other reasonably requests in connection with the performance of its obligations under the New Accord. All such information would be required to be kept confidential, using the same care and discretion that each clearing agency uses for the safekeeping of its own members' confidential information. NSCC and OCC would each be required to act in good faith to resolve and notify the other of any errors, discrepancies or delays in the information it provides.

The New Accord also would include new terms to provide that, to the extent one party is unable to perform any obligation as a result of the failure of the other party to perform its responsibilities on a timely basis, the time for the non-failing party's performance would be extended, its performance would be reduced to the extent of any such impairment, and it would not be liable for any failure to perform its obligations. Further, NSCC and OCC would agree that neither party would be liable to the other party in connection with its performance of its obligations under the proposed New Accord to the extent it has acted, or omitted or ceased to act, with the permission or at the direction of a governmental authority. Moreover, the proposed New Accord would provide that in no case would either clearing agency be liable to the other for punitive, incidental or consequential damages. The purpose of these new provisions is to provide clear and specific terms regarding each clearing agency's liability for non-performance under the agreement.

The proposed New Accord would also contain the usual and customary representations and warranties for an agreement of this type, including representations as to the parties' good standing, corporate power and authority and operational capability, that the agreement complies with laws and all government documents and does not violate any agreements, and that all of the required regulatory notifications and filings would be obtained prior to the New Accord's effective date. It would also include representations that the proposed New Accord constitutes a legal, valid and binding obligation on each of OCC and NSCC and is enforceable against each, subject to standard exceptions. Furthermore, the proposed New Accord would contain a force majeure provision, under which NSCC and OCC would agree to notify the other no later than two hours upon learning that a force majeure event has occurred and both parties would be required to cooperate in good faith to mitigate the effects of any resulting inability to perform or delay in performing.

## **Proposed Amendments to OCC's By-Laws and Rules**

Given the key differences between the Existing Accord and the New Accord, as described above, OCC proposes certain changes to its By-Laws and Rules in order to accommodate the terms of the New Accord. The primary purpose of the proposed changes is to: (1) reflect the expanded scope of the New Accord, (2) reflect changes related to the new Guaranty Substitution mechanics of the New Accord; and (3) make other changes necessary to conform to the terms of the New Accord or to otherwise provide additional clarity around the settlement and margining<sup>18</sup> treatment of: (i) Eligible Securities under the New Accord, (ii) non-regular way securities settling through the facilities of NSCC but outside of the New Accord, and (iii) those securities settling outside of the New Accord and away from NSCC on a broker-to-broker basis. These proposed changes are discussed in greater detail below.

### *Changes Related to the Expanded Scope of the New Accord*

First, OCC proposes to amend and replace the defined term "CNS-eligible"<sup>19</sup> in order to reflect the expanded definition of Eligible Securities under the New Accord. The term "CNS-eligible" currently describes the securities underlying the physically-settled stock options that are eligible under the Existing Accord to be settled through NSCC's CNS Accounting Operation. Under the New Accord, however, the term Eligible Securities is more broadly defined to include securities (both Stock Options and Stock Futures) eligible for settlement via NSCC's CNS Accounting Operation and NSCC's Balance Order Accounting Operation. Accordingly, OCC proposes to use "CCC," for "correspondent clearing corporation"<sup>20</sup> to describe the Eligible Securities. Thus, the term "CCC-eligible" would replace "CNS-eligible" throughout OCC's By-Laws and Rules.

Next, because the New Accord would include the settlement of Stock Futures, OCC proposes to make several changes to its rules regarding Stock Futures to accommodate this expansion. More specifically, OCC proposes a conforming amendment to Rule 901 Interpretation and Policy (.02) to clarify that, under the New Accord, OCC will, subject to its discretion, cause the settlement of all matured Stock Futures to be made through the facilities of

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<sup>18</sup> OCC notes that, while it is proposing changes to its Rules concerning margin requirements (e.g., which transactions would be included as part of OCC's margin calculation at a given point in time), OCC is not proposing any changes to its margin model (with the exception that OCC would no longer collect and hold margin for positions after NSCC's Guaranty has taken effect under the New Accord).

<sup>19</sup> See Article I, Section (C)(23) of OCC's By-Laws.

<sup>20</sup> Under Article I of OCC's By-Laws, the term "correspondent clearing corporation" means the National Securities Clearing Corporation or any successor thereto which, by agreement with the Corporation, provides facilities for settlements in respect of exercised option contracts or BOUNDS or in respect of delivery obligations arising from physically-settled stock futures.

NSCC to the extent that the underlying securities are CCC-eligible as the term is currently proposed.

OCC also proposes clarifying and conforming revisions to newly renumbered Rule 901(e) (currently Rule 901(d)) to specify that settlements made through the facilities of the correspondent clearing corporation are governed by Rule 901 and to clarify that, under the New Accord, specifications made in any Delivery Advice may be revoked up until the point at which NSCC's Guaranty has taken effect (the "obligation time" as discussed below) and not the opening of business on the delivery date.

#### *Changes Related to Guaranty Substitution*

OCC also proposes a series of amendments to its Rules to accurately reflect the process under which the Guaranty Substitution occurs under the New Accord. First, OCC proposes to amend Rule 901(c) so that the term "obligation time" -- the time that the correspondent clearing corporation becomes unconditionally obligated, in accordance with its rules, to effect settlement in respect thereof or to close out the securities contract arising therefrom -- is synonymous with the Guaranty Substitution Time under the New Accord and (i.e., (i) settlement obligations are reported to and are not rejected by NSCC; (ii) NSCC has not notified OCC that it has ceased to act for the relevant Clearing Member; and (iii) the Clearing Fund requirements of the relevant Clearing Member are received by NSCC). Under the New Accord, if a default occurs prior to the Guaranty Substitution Time, the Guaranty Substitution will not occur for any E&A/Delivery Transactions involving the Defaulting NSCC Member, and OCC will continue to guarantee settlement for those Defaulted NSCC Member Transactions.

Next, OCC proposes to amend language in newly renumbered Rule 901(i) (currently Rule 901(h)) regarding the timing of the end of a Clearing Member's obligations to OCC with respect to securities to be settled through NSCC. Under the Existing Accord and OCC's existing Rules, a Clearing Member's obligations to OCC end only once settlement is completed. Under the New Accord, however, a Clearing Member's obligations to OCC will end when OCC's obligations with respect to guaranteeing settlement of the security would end (i.e., the Guaranty Substitution Time or "obligation time"). OCC therefore proposes to amend newly renumbered Rule 901(i) to specify that a Clearing Member's obligations to OCC will be deemed completed and performed once the "obligation time" has occurred.

As discussed above, the New Accord eliminates the provisions of the Existing Accord whereby OCC and NSCC guaranteed each other the performance of Common Members and made certain payments to the other upon the default of a Common Member. As such, OCC proposes to delete discussions of such guarantees and payments from newly renumbered Rule 901(i) and Rule 1107.

OCC also proposes amendments to Rules 910 and 911, which set forth procedures for handling failures to make or take delivery of securities in settlement of exercised or assigned

Stock Options and matured physically-settled Stock Futures, to add language to both rules to clarify that the failure procedures set forth therein would not apply with respect to any delivery to be made through NSCC pursuant to Rule 901. Under the New Accord, once the Guaranty Substitution Time with respect to a specific E&A/Delivery Transaction occurs, OCC's Guaranty ends and NSCC's Guaranty begins, leaving OCC with no involvement with or responsibility for the settlement of the securities underlying that transaction. Therefore, if there is a failure to make or take delivery with respect to that transaction after Guaranty Substitution has occurred, the NSCC Rules will govern that failure. With respect to deliveries made on a broker-to-broker basis under OCC Rules 903 through 912 (including those that may utilize NSCC's Obligation Warehouse services), and which are not governed by Rule 901, Guaranty Substitution does not occur and OCC's failure procedures would apply.

#### *Changes to OCC's Margin Rules*

Under the New Accord, OCC will no longer collect margin on a transaction once it is no longer guaranteeing settlement for that transaction. As such, OCC proposes to add language to Rule 601(f) to clarify that OCC's margin calculations will not include delivery obligations arising from any Stock Options or Stock Futures that are eligible for settlement through NSCC and for which OCC has no further settlement obligations because either (i) Guaranty Substitution has occurred for E&A/Delivery Transactions under the New Accord (as described in revised Rule 901(c)) or (ii) NSCC has otherwise accepted transactions for non-regular way settlement under the NSCC Rules (as describe in newly proposed Rule 901(d)).<sup>21</sup> By not including these transactions as part of OCC's margin calculation, OCC is hoping to alleviate instances of "double-margining" for Common Members that may otherwise simultaneously owe margin to NSCC and OCC with respect to the same position.

OCC also proposes to delete Rule 608A in its entirety. The New Accord seeks to eliminate the situation under the Existing Accord where Common Members are effectively "double-margining" or required to simultaneously post margin with OCC and NSCC with respect to the same position. As the New Accord eliminates this double-margining scenario, Rule 608A, which provides procedures pursuant to which a Clearing Member could use the securities deposited as margin with OCC as collateral to secure a loan to pay its margin obligations to NSCC, is now unnecessary.

#### *Other Clarifying Changes Not Related to the New Accord*

OCC also proposes to amend its Rules to make clarifying changes that are not directly required by the New Accord but would provide additional clarity in its Rules in light of other changes being made to accommodate the New Accord. Specifically, OCC proposes to revise Rule 901 Interpretation and Policy (.02) to provide that transactions that involve the delivery of

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<sup>21</sup> Related revisions to Rule 901(c) and newly proposed Rule 901(d) are discussed in more detail below.

non-CCC eligible securities made on a broker-to-broker basis (and away from NSCC) may nevertheless involve the use of certain services of NSCC (*e.g.*, NSCC's Obligation Warehouse). For such transactions, because they are not covered by the New Accord and NSCC at no point guarantees settlement, OCC Rule 901 would not apply and delivery is governed by the broker-to-broker settlement procedures set forth in OCC Rules 903 through 912, as is the case currently today. Additionally, while OCC's existing Rules do not prohibit broker-to-broker settlements from being facilitated through the services of a correspondent clearing corporation, they do not explicitly contemplate the possibility. OCC also proposes to make clarifying amendments to Rule 904(b) and 910A(a) to more clearly distinguish between settlements effected through NSCC's CNS Accounting Operation or Balance Order Accounting Operations in accordance with OCC Rule 901 and deliveries effected on a broker-to-broker basis utilizing services of NSCC under OCC Rules 903 through 912 and to clearly state which OCC Rules apply in each context.

Further, OCC proposes to add a new paragraph (d) to Rule 901 to clarify that OCC still intends, at its discretion, to effect settlement of Stock Options and Stock Futures that are scheduled to be settled on the first business day after exercise or maturity through NSCC pursuant to Rule 901 and the relevant provisions of the NSCC Rules, even though such contracts are outside the scope of the New Accord. These contracts would continue to be settled as they are currently today.

OCC also proposes clarifying and conforming changes to the introductory language of Chapter IX of the Rules. Specifically, OCC proposes conforming changes to the Rule to reflect the replacement of the defined term "CNS-eligible" with "CCC-eligible" as described above. The proposed changes would also clarify that OCC's broker-to-broker settlement rules are contained in Rules 903-912, as Rule 902 concerns Delivery Advices, which also may be applicable to settlements made through the correspondent clearing corporation pursuant to Rule 901. In addition, the proposed changes to the introductory language of Chapter IX of the Rules would provide additional clarity around OCC's existing authority to alter a previous designation of a settlement method at any time prior to the designated delivery date by specifying that this authority would apply to both settlements to be made through the facilities of the correspondent clearing corporation pursuant to Rule 901 or settlements to be made on a broker-to-broker basis pursuant to Rules 903 through 912. Finally, OCC proposes a number of conforming changes to Rules 901 and 912 to reflect the renumbering of various Rule provisions due to the proposed amendments described above.

OCC reviewed the derivatives clearing organization ("DCO") core principles ("Core Principles") as set forth in the Act. During this review, OCC identified the following Core Principles as potentially being impacted:

**Legal Risk Considerations.** CFTC Regulation 39.27(b) requires that a derivatives clearing organization operate pursuant to a well-founded, transparent, and enforceable legal framework that addresses each aspect of the activities of the derivatives clearing organization.

The New Accord would constitute a legal, valid and binding obligation on each of OCC and NSCC, which is enforceable against each clearing agency. The New Accord, and the By-Laws and Rules changes associated therewith, would establish clear, transparent, and enforceable terms for the settlement of OCC's cleared Stock Options and Stock Futures through the facilities of NSCC and would simplify the settlement process for those Stock Options currently settled under the Existing Accord. By clarifying the timing and mechanisms by which OCC's Guaranty ends and NSCC's Guaranty begins by focusing on the timing of the Guaranty Substitution, the new Accord, specifically the proposal to enhance the timing of the Guaranty Substitution, would provide a clear, transparent and enforceable legal basis for OCC's obligations during the event of a Common Member default.

**Settlement Procedures.** CFTC Regulation 39.14(g) requires derivatives clearing organizations to, among other things, establish rules that clearly state each obligation that the derivatives clearing organization has assumed with respect to physical deliveries and ensure that the risks of each such obligation are identified and managed. The proposed rule change would continue to provide a sound framework for the settlement of certain Stock Options issued and cleared by OCC through the facilities of NSCC and would extend this framework to a clearly defined scope of additional Stock Options and Stock Futures transactions. In particular, the proposed rule change would reduce the operational complexities of the Existing Accord by eliminating the cross-guaranty between OCC and NSCC and the bifurcated risk management of exercised and assigned or matured transactions between the two clearing agencies by delineating a single point in time at which OCC's Guaranty ceases and NSCC's Guaranty begins. As a result, the proposed rule change would eliminate any ambiguity regarding which clearing agency is responsible for guaranteeing settlement at any given moment. Establishing a precise Guaranty Substitution Time would also provide greater certainty that in the event of a Common Member default, the default would be handled pursuant to the rules and procedures of the clearing agency whose guarantee is then in effect and the system for the clearance and settlement of Stock Options and Stock Futures would continue with minimal interruption. This greater certainty would strengthen OCC's ability to plan for and manage, and therefore would mitigate, the risk presented by Common Member defaults to OCC and NSCC, other members, and the markets the clearing agencies serve.

#### Opposing Views

No opposing views were expressed related to the rule amendments.

#### Notice of Pending Rule Certification

OCC hereby certifies that notice of this rule filing has been given to Clearing Members of OCC in compliance with Regulation 40.6(a)(2) by posting a copy of the submission on OCC's website concurrently with the filing of this submission.

Christopher J. Kirkpatrick  
June 6, 2017  
Page 16

Certification

OCC hereby certifies that the rule set forth at Item 1 of the enclosed filing complies with the Act and the CFTC's regulations thereunder.

Should you have any questions regarding this matter, please do not hesitate to contact me.

Sincerely,



Justin W. Byrne  
Vice President, Regulatory Filings

Enclosure



Required fields are shown with yellow backgrounds and asterisks.

Page 1 of * <input type="text" value="97"/>	SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549 Form 19b-4	File No.* SR - <input type="text" value="2017"/> - * <input type="text" value="013"/> Amendment No. (req. for Amendments *) <input type="text"/>
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Filing by Options Clearing Corporation  
Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial * <input checked="" type="checkbox"/>	Amendment * <input type="checkbox"/>	Withdrawal <input type="checkbox"/>	Section 19(b)(2) * <input checked="" type="checkbox"/>	Section 19(b)(3)(A) * <input type="checkbox"/>	Section 19(b)(3)(B) * <input type="checkbox"/>
Pilot <input type="checkbox"/> Extension of Time Period for Commission Action * <input type="checkbox"/> Date Expires * <input type="text"/>			Rule <input type="checkbox"/> 19b-4(f)(1) <input type="checkbox"/> 19b-4(f)(4) <input type="checkbox"/> 19b-4(f)(2) <input type="checkbox"/> 19b-4(f)(5) <input type="checkbox"/> 19b-4(f)(3) <input type="checkbox"/> 19b-4(f)(6)		

Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010 Section 806(e)(1) * <input type="checkbox"/> Section 806(e)(2) * <input type="checkbox"/>	Security-Based Swap Submission pursuant to the Securities Exchange Act of 1934 Section 3C(b)(2) * <input type="checkbox"/>
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Exhibit 2 Sent As Paper Document <input type="checkbox"/>	Exhibit 3 Sent As Paper Document <input type="checkbox"/>
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**Description**  
Provide a brief description of the action (limit 250 characters, required when Initial is checked \*).

Proposed rule change by The Options Clearing Corporation concerning a new Stock Options and Futures Settlement Agreement ("New Accord") between OCC and the National Securities Clearing Corporation.

**Contact Information**  
Provide the name, telephone number, and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the action.

First Name \*     Last Name \*   
 Title \*   
 E-mail \*   
 Telephone \*     Fax

**Signature**  
Pursuant to the requirements of the Securities Exchange Act of 1934,  
has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.  
(Title \*)

Date       
 By    

(Name \*)

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFF website.

**Form 19b-4 Information \***

Add Remove View

The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

**Exhibit 1 - Notice of Proposed Rule Change \***

Add Remove View

The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

**Exhibit 1A- Notice of Proposed Rule Change, Security-Based Swap Submission, or Advance Notice by Clearing Agencies \***

Add Remove View

The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change, security-based swap submission, or advance notice being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

**Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications**

Add Remove View

Exhibit Sent As Paper Document

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

**Exhibit 3 - Form, Report, or Questionnaire**

Add Remove View

Exhibit Sent As Paper Document

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

**Exhibit 4 - Marked Copies**

Add Remove View

The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

**Exhibit 5 - Proposed Rule Text**

Add Remove View

The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

**Partial Amendment**

Add Remove View

If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

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Form 19b-4

Proposed Rule Change  
by

**THE OPTIONS CLEARING CORPORATION**

Pursuant to Rule 19b-4 under the  
Securities Exchange Act of 1934

**Item 1. Text of the Proposed Rule Change**

This proposed rule change is filed by The Options Clearing Corporation (“OCC”) in connection with proposed changes relating to a new Stock Options and Futures Settlement Agreement (“New Accord”) between OCC and the National Securities Clearing Corporation (“NSCC,” collectively NSCC and OCC may be referred to herein as the “clearing agencies”) and amendments to OCC’s By-Laws and Rules to accommodate the proposed provisions of the New Accord.

The proposed changes to OCC’s By-Laws and Rules and the proposed New Accord are attached hereto as Exhibits 5A - 5C, respectively.<sup>1</sup> Material proposed to be added to OCC’s By-Laws and Rules as currently in effect is marked by underlining and material proposed to be deleted is marked by strikethrough text. With respect to the New Accord, underlining and strikethrough text have been omitted to enhance readability due to the significance of the proposed changes, both in terms of substance and quantity.

The proposed changes are described in detail in Item 3 below. All terms with initial capitalization not defined herein have the same meaning as set forth in OCC’s By-Laws and Rules.<sup>2</sup>

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<sup>1</sup> OCC has filed an advance notice with the Commission in connection with the New Accord. See SR-OCC-2017-804. NSCC also has filed proposed rule change and advance notice filings with the Commission in connection with the New Accord. See NSCC filings SR-NSCC-2017-007 and SR-NSCC-2017-803, respectively.

<sup>2</sup> OCC’s By-Laws and Rules can be found on OCC’s public website: <http://optionsclearing.com/about/publications/bylaws.jsp>. Other terms not defined herein or in the OCC By-Laws and Rules can be found in the Rules & Procedures of NSCC (“NSCC Rules”),

**Item 2. Procedures of the Self-Regulatory Organization**

The proposed rule change was approved for filing with the Commission by the Risk Committee of the Board of Directors of OCC at a meeting held on February 11, 2015, pursuant to authority delegated by the Board of Directors at a meeting held on May 20, 2014.

Questions should be addressed to Justin Byrne, Vice President, Regulatory Filings, at (202) 971-7238.

**Item 3. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change**

A. Purpose

**Background**

OCC issues and clears U.S.-listed options and futures on a number of underlying financial assets including common stocks, currencies and stock indices. OCC’s Rules, however, provide that delivery of, and payment for, securities underlying certain physically settled stock options and single stock futures cleared by OCC are effected through the facilities of a correspondent clearing corporation (i.e., NSCC) and are not settled through the facilities OCC. OCC and NSCC are parties to a Third Amended and Restated Options Exercise Settlement Agreement, dated February 16, 1995, as amended (“Existing Accord”),<sup>3</sup> which governs the

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available at [http://www.dtcc.com/~media/Files/Downloads/legal/rules/nscc\\_rules.pdf](http://www.dtcc.com/~media/Files/Downloads/legal/rules/nscc_rules.pdf), as the context implies.

<sup>3</sup> The Existing Accord and the proposed changes thereunder were previously approved by the Commission. See Securities Exchange Act Release No. 37731 (September 26, 1996), 61 FR 51731 (October 3, 1996) (SR-OCC-96-04 and SR-NSCC-96-11) (Order Approving Proposed Rule Change Related to an Amended and Restated Options Exercise Settlement Agreement

delivery and receipt of stock in the settlement of put and call options issued by OCC (“Stock Options”) that are eligible for settlement through NSCC’s Continuous Net Settlement (“CNS”) Accounting Operation and are designated to settle on the third business day following the date the related exercise or assignment was accepted by NSCC (“Options E&A”). All OCC Clearing Members that intend to engage in Stock Options transactions are required to also be Members of NSCC or to have appointed or nominated an NSCC Member to act on its behalf.<sup>4</sup>

OCC proposes to adopt a New Accord with NSCC, which would provide for the settlement of certain Stock Options and delivery obligations arising from certain matured physically-settled stock futures contracts cleared by OCC (“Stock Futures”). Specifically, the New Accord would, among other things: (1) expand the category of securities that are eligible for settlement and guaranty under the agreement to certain securities (including stocks, exchange-traded funds and exchange-traded notes) that (i) are required to be delivered in the exercise and assignment of Stock Options and are eligible to be settled through NSCC’s Balance Order Accounting Operation (in addition to its CNS Accounting Operation) or (ii) are delivery

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Between the Options Clearing Corporation and the National Securities Clearing Corporation); Securities Exchange Act Release No. 43837 (January 12, 2001), 66 FR 6726 (January 22, 2001) (SR-OCC-00-12) (Order Granting Accelerated Approval of a Proposed Rule Change Relating to the Creation of a Program to Relieve Strains on Clearing Members’ Liquidity in Connection With Exercise Settlements); and Securities Exchange Act Release No. 58988 (November 20, 2008), 73 FR 72098 (November 26, 2008) (SR-OCC-2008-18 and SR-NSCC-2008-09) (Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Changes Relating to Amendment No. 2 to the Third Amended and Restated Options Exercise Settlement Agreement).

<sup>4</sup> A firm that is both an OCC Clearing Member and an NSCC Member, or is an OCC Clearing Member that has designated an NSCC Member to act on its behalf is referred to herein as a “Common Member.”

obligations arising from Stock Futures that have reached maturity and are eligible to be settled through NSCC's CNS Accounting Operation or Balance Order Accounting Operation; (2) modify the time of the transfer of responsibilities from OCC to NSCC and, specifically, when OCC's guarantee obligations under OCC's By-Laws and Rules with respect to such transactions ("OCC's Guaranty") end and NSCC's obligations under Addendum K of the NSCC Rules with respect to such transactions ("NSCC's Guaranty") begin (such transfer being the "Guaranty Substitution"); and (3) put additional arrangements into place concerning the procedures, information sharing, and overall governance processes under the agreement. Furthermore, OCC proposes to make certain clarifying and conforming changes to the OCC By-Laws and Rules as necessary to implement the New Accord.

The primary purpose of the proposed changes is to (1) provide consistent treatment across all expiries for products with "regular way"<sup>5</sup> settlement cycle specifications; (2) reduce the operational complexities of the Existing Accord by eliminating the cross-guaranty between OCC and NSCC and the bifurcated risk management of exercised and assigned transactions

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<sup>5</sup> Under the New Accord, "regular way settlement" shall have a meaning agreed to by the clearing agencies. Generally, regular way settlement is understood to be the financial services industry's standard settlement cycle. Currently, regular way settlement of Stock Options or Stock Futures transactions are those transactions designated to settle on the third business day following the date the related exercise, assignment or delivery obligation was accepted by NSCC. NSCC has proposed to change the NSCC Rules with respect to the meaning of regular way settlement in order to be consistent with the anticipated industry-wide move to a shorter standard settlement cycle of two business days after trade date. See Securities Exchange Act Release No. 79734 (January 4, 2017), 82 FR 3030 (January 10, 2017) (SR-NSCC-2016-007). See also Securities Exchange Act Release No. 78962 (September 28, 2016), 81 FR 69240 (October 5, 2016) (S7-22-16) (Amendment to Securities Transaction Settlement Cycle).

between the two clearing agencies by delineating a single point in time at which OCC's Guaranty ceases and NSCC's Guaranty begins; (3) further solidify the roles and responsibilities of OCC and NSCC in the event of a default of a Common Member at either or both clearing agencies; and (4) improve procedures, information sharing, and overall governance under the agreement.

The New Accord would become effective, and wholly replace the Existing Accord, at a date specified in a service level agreement to be entered into between NSCC and OCC.<sup>6</sup>

### **The Existing Accord**

#### *Key Terms of the Existing Accord*

Under the Existing Accord, the settlement of Options E&A generally proceeds according to the following sequence of events. NSCC maintains and delivers to OCC a list ("CNS Eligibility Master File") that enumerates all CNS Securities, which are defined in NSCC's Rule 1 and generally include securities that have been designated by NSCC as eligible for processing through NSCC's CNS Accounting Operation and eligible for book entry delivery at NSCC's affiliate, The Depository Trust Company (for purposes of this proposed rule change, such securities are referred to as "CNS Eligible Securities").<sup>7</sup> OCC, in turn, uses this file to make a final determination of which securities NSCC would not accept and therefore would need to be

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<sup>6</sup> Such effective date would be a date following approval of all required regulatory submissions to be filed by OCC and NSCC with the appropriate regulatory authorities, including this proposed rule change. See supra note 1.

<sup>7</sup> See supra note 2.



settled on a broker-to-broker basis. OCC then sends to NSCC a transactions file,<sup>8</sup> listing the specific securities that are to be delivered and received in settlement of an Options E&A that have not previously been reported to NSCC and for which settlement is to be made through NSCC (“OCC Transactions File”).<sup>9</sup> With respect to each Options E&A, the OCC Transactions File includes the CUSIP number of the security to be delivered, the identities of the delivering and receiving Common Members, the quantity to be delivered, the total value of the quantity to be delivered based on the exercise price of the option for which such security is the underlying security, and the exercise settlement date. After receiving the OCC Transactions File, NSCC then has until 11:00 AM Central Time on the following business day to reject any transaction listed in the OCC Transactions File. NSCC can reject a transaction if the security to be delivered has not been listed as a CNS Eligible Security in the CNS Eligible Master File or if information provided in the OCC Transactions File is incomplete. Otherwise, if NSCC does not so notify OCC of its rejection of an Options E&A by the time required under the Existing Accord, NSCC will become unconditionally obligated to effect settlement of the Options E&A.

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<sup>8</sup> Delivery of the OCC Transactions File with respect to an Options E&A typically happens on the date of the option’s exercise or expiration, though this is not expressly stated in the Existing Accord. In theory, however, an Options E&A could, due to an error or delay, be reported later than the date of the option’s exercise or expiration.

<sup>9</sup> This process would be substantially the same under the New Accord with the exception that the CNS Eligibility Master File and OCC Transactions File would be renamed and would be expanded in scope to include additional securities that would be eligible for guaranty and settlement under the New Accord, as discussed in further detail below.

Under the Existing Accord, even after NSCC's trade guarantee has come into effect,<sup>10</sup> OCC is not released from its guarantee with respect to the Options E&A until certain deadlines<sup>11</sup> have passed on the first business day following the scheduled settlement date without NSCC notifying OCC that the relevant Common Member has failed to meet an obligation to NSCC or NSCC has ceased to act for such Common Member pursuant to the NSCC Rules.<sup>12</sup> As a result, there is a period of time when NSCC's trade guarantee overlaps with OCC's guarantee and where both clearing agencies are holding margin against the same Options E&A position.

In the event that NSCC or OCC ceases to act on behalf of or suspends a Common Member, that Common Member becomes a "defaulting member." Once a Common Member becomes a defaulting member, the Existing Accord provides that NSCC will make a payment to OCC equal to the lesser of OCC's loss or the positive mark-to-market amount relating to the defaulting member's Options E&A and that OCC will make a payment to NSCC equal to the lesser of NSCC's loss or the negative mark-to-market amount relating to the defaulting

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<sup>10</sup> Pursuant to Addendum K of the NSCC Rules, NSCC guarantees the completion of CNS transactions and balance order transactions that have reached the point at which, for bi-lateral submissions by Members, such trades have been validated and compared by NSCC, and for locked-in submission, such trades have been validated by NSCC, as described in the NSCC Rules. Transactions that are covered by the Existing Accord, and that would be covered by the New Accord, are expressly excluded from the timeframes described in Addendum K. See supra note 2.

<sup>11</sup> The deadline is 6:00 AM Central Time for NSCC notifying OCC of a Common Member failure and, if NSCC does not immediately cease to act for such defaulting Common Member, 4:00 PM Central Time for notifying OCC that it has ceased to act.

<sup>12</sup> See NSCC Rule 46 (Rule 46 (Restrictions on Access to Services)). See supra note 2.

member's Options E&A to compensate for potential losses incurred in connection with the default. A clearing agency must request the transfer of any such payments by the close of business on the tenth business day following the day of default and, after a request is made, the other clearing agency is required to make payment within five business days of the request.

## **The New Accord**

### *Overview*

As noted above, NSCC proposes to adopt a New Accord with OCC, which would provide for the settlement of certain Stock Options and Stock Futures transactions. The New Accord is primarily designed to, among other things, expand the category of securities that are eligible for settlement and guaranty under the agreement; simplify the time of the transfer of responsibilities from OCC to NSCC (specifically, the transfer of guarantee obligations); and put additional arrangements into place concerning the procedures, information sharing, and overall governance processes under the agreement. The material provisions of the New Accord are described in detail below.

### *Key Elements of the New Accord*

#### Expanded Scope of Eligible Securities

Pursuant to the proposed New Accord, on each day that both OCC and NSCC are open for accepting trades for clearing ("Activity Date"), NSCC would deliver to OCC an "Eligibility Master File," which would identify the securities, including stocks, exchange-traded funds and exchange-traded notes, that are (1) eligible to settle through NSCC's CNS Accounting Operation

(as is currently the case under the Existing Accord) or NSCC's Balance Order Accounting Operation (which is a feature of the New Accord) and (2) to be delivered in settlement of (i) exercises and assignments of Stock Options (as is currently the case under the Existing Accord) or (ii) delivery obligations arising from maturing physically settled Stock Futures (which is a feature of the New Accord) (all such securities collectively being "Eligible Securities"). OCC, in turn, would deliver to NSCC its file of E&A/Delivery Transactions<sup>13</sup> that list the Eligible Securities to be delivered, or received, and for which settlement is proposed to be made through NSCC on that Activity Date. Guaranty Substitution (discussed further below) would not occur with respect to an E&A/Delivery Transaction that is not submitted in the proper format or that involves a security that is not identified as an Eligible Security on the then-current Eligibility Master File. This process is similar to the current process under the Existing Accord with the exception of the expanded scope of Eligible Securities (and additional fields necessary to accommodate such securities) that would be listed on the Eligibility Master File and the E&A/Delivery Transactions file.

Like the Existing Accord, the proposed New Accord would continue to facilitate the processes by which Common Members deliver and receive stock in the settlement of Stock

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<sup>13</sup> "E&A/Delivery Transactions" are transactions involving the settlement of Stock Options and Stock Futures under the New Accord. The delivery of E&A/Delivery Transactions to NSCC would replace the delivery of the "OCC Transactions File" from the Existing Accord. The actual information delivered by OCC to NSCC would be the same as is currently provided on the OCC Transactions File, but certain additional terms would be included to accommodate the inclusion of Stock Futures, along with information regarding the date that the instruction to NSCC was originally created and the E&A/Delivery Transaction's designated settlement date.

Options that are eligible to settle through NSCC's CNS Accounting Operation and are designated to settle regular way. The New Accord would also expand the category of securities eligible for settlement under the agreement. In particular, the New Accord would facilitate the processes by which Common Members deliver and receive stock in settlement of Stock Futures that are eligible to settle through NSCC's CNS Accounting Operation and are designated to settle regular way. It would also provide for the settlement of both Stock Options and Stock Futures that are eligible to settle through NSCC's Balance Order Accounting Operation on a regular way basis. The primary purpose of expanding the category of securities that are eligible for settlement and guaranty under the agreement is to provide consistent treatment across all expiries for products with regular way settlement cycle specifications and simplify the settlement process for these additional securities transactions.

The New Accord would not apply to Stock Options or Stock Futures that are designated to settle on a shorter timeframe than the regular way settlement timeframe. These Stock Options would continue to be processed and settled as they would be today, outside of the New Accord. The New Accord also would not apply to any Stock Options or Stock Futures that are neither CNS Securities nor Balance Order Securities.<sup>14</sup> Transactions in these securities are, and would continue to be, processed on a trade-for-trade basis away from NSCC's facilities. Such

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<sup>14</sup> Balance Order Securities are defined in NSCC Rule 1, and are generally securities, other than foreign securities, that are eligible to be cleared at NSCC but are not eligible for processing through the CNS Accounting Operation. See supra note 2.

transactions may utilize other NSCC services for which they are eligible, but would not be subject to the New Accord.<sup>15</sup>

Proposed Changes Related to Guaranty Substitution

The New Accord would adopt a fundamentally different approach to the delineation of the rights and responsibilities of OCC and NSCC with respect to E&A/Delivery Transactions. The purpose of the proposed changes related to the Guaranty Substitution, defined below, is to reduce the operational complexities of the Existing Accord by eliminating the cross-guaranty between OCC and NSCC and the bifurcated risk management of exercised and assigned transactions between the two clearing agencies and delineating a single point in time at which OCC's Guaranty ceases and NSCC's Guaranty begins. Moreover, the proposed changes would solidify the roles and responsibilities of OCC and NSCC in the event of a default of a Common Member at either or both clearing agencies.

As described above, the Existing Accord provides that NSCC will make a payment to OCC following the default of a Common Member in an amount equal to the lesser of OCC's loss or the positive mark-to-market amount relating to the Common Member's Options E&A, and provides that OCC will make a payment to NSCC following the default of a Common Member equal to the lesser of NSCC's loss or the negative mark-to-market amount relating to the Common Member's Options E&A to compensate for potential losses incurred in connection with

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<sup>15</sup> OCC will continue to guarantee settlement until settlement actually occurs with respect to these Stock Options and Stock Futures.

the Common Member's default. The proposed New Accord, in contrast, would focus on the transfer of responsibilities from OCC to NSCC and, specifically, the point at which OCC's Guaranty ends and NSCC's Guaranty begins (i.e., the Guaranty Substitution) with respect to E&A/Delivery Transactions. By focusing on the timing of the Guaranty Substitution, rather than payment from one clearing agency to the other, the New Accord would simplify the agreement and the procedures for situations involving the default of a Common Member. The New Accord additionally would minimize "double-margining" situations when a Common Member may simultaneously owe margin to both NSCC and OCC with respect to the same E&A/Delivery Transaction.

After NSCC has received an E&A/Delivery Transaction, the Guaranty Substitution would normally occur when NSCC has received all Required Deposits to its Clearing Fund, calculated taking into account such E&A/Delivery Transaction, of Common Members ("Guaranty Substitution Time").<sup>16</sup> At the Guaranty Substitution Time, NSCC's Guaranty takes effect, and OCC does not retain any settlement obligations with respect to such E&A/Delivery Transactions. The Guaranty Substitution would not occur, however, with respect to any E&A/Delivery Transaction if NSCC has rejected such E&A/Delivery Transaction due to an improper submission, as described above, or if, during the time after NSCC's receipt of the

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<sup>16</sup> Procedure XV of the NSCC Rules provides that all Clearing Fund requirements and other deposits must be made within one hour of demand, unless NSCC determines otherwise. See supra note 2.

E&A/Delivery Transaction but prior to the Guaranty Substitution Time, a Common Member involved in the E&A/Delivery Transaction has defaulted on its obligations to NSCC by failing to meet its Clearing Fund obligations, or NSCC has otherwise ceased to act for such Common Member pursuant to the NSCC Rules (in either case, such Common Member becomes a “Defaulting NSCC Member”).

NSCC would be required to promptly notify OCC if a Common Member becomes a Defaulting NSCC Member, as described above. Upon receiving such a notice, OCC would not submit to NSCC any further E&A/Delivery Transactions involving the Defaulting NSCC Member for settlement, unless authorized representatives of both OCC and NSCC otherwise consent. OCC would, however, deliver to NSCC a list of all E&A/Delivery Transactions that have already been submitted to NSCC and that involve the Defaulting NSCC Member (“Defaulted NSCC Member Transactions”). The Guaranty Substitution ordinarily would not occur with respect to any Defaulted NSCC Member Transactions, unless both clearing agencies agree otherwise. As such, NSCC would have no obligation to guaranty such Defaulted NSCC Member Transactions, and OCC would continue to be responsible for effecting the settlement of such Defaulted NSCC Member Transactions pursuant to OCC’s By-Laws and Rules. Once NSCC has confirmed the list of Defaulted NSCC Member Transactions, Guaranty Substitution would occur for all E&A/Delivery Transactions for that Activity Date that are not included on such list. NSCC would be required to promptly notify OCC upon the occurrence of the Guaranty Substitution Time on each Activity Date.



If OCC suspends a Common Member after NSCC has received the E&A/Delivery Transactions but before the Guaranty Substitution has occurred, and that Common Member has not become a Defaulting NSCC Member, the Guaranty Substitution would proceed at the Guaranty Substitution Time. In such a scenario, OCC would continue to be responsible for guaranteeing the settlement of the E&A/Delivery Transactions in question until the Guaranty Substitution Time, at which time the responsibility would transfer to NSCC. If, however, the suspended Common Member also becomes a Defaulting NSCC Member after NSCC has received the E&A/Delivery Transactions but before the Guaranty Substitution has occurred, Guaranty Substitution would not occur, and OCC would continue to be responsible for effecting the settlement of such Defaulted NSCC Member Transactions pursuant to OCC's By-Laws and Rules (unless both clearing agencies agree otherwise).

Finally, the New Accord also would provide for the consistent treatment of all exercise and assignment activity under the agreement. Under the Existing Accord, "standard"<sup>17</sup> option contracts become guaranteed by NSCC when the Common Member meets its morning Clearing Fund Required Deposit at NSCC while "non-standard" exercise and assignment activity becomes guaranteed by NSCC at midnight of the day after trade date (T+1). Under the New Accord, all exercise and assignment activity for Eligible Securities would be guaranteed by NSCC as of the Guaranty Substitution Time, under the circumstances described above, further simplifying the

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<sup>17</sup> Option contracts with "standard" expirations expire on the third Friday of the specified expiration month, while "non-standard" contracts expire on other days of the expiration month.

framework for the settlement of such contracts.

*Other Terms of the New Accord*

The New Accord also would include a number of other provisions intended to either generally maintain certain terms of the Existing Accord or improve the procedures, information sharing, and overall governance process under the new agreement. Many of these terms are additions to or improvements upon the terms of the Existing Accord.

Under the proposed New Accord, OCC and NSCC would agree to address the specifics regarding the time, form and manner of various required notifications and actions in a separate service level agreement which the parties would be able to revisit as their operational needs evolve. The service level agreement would also specify an effective date for the New Accord, which, as mentioned above, would occur on a date following approval and effectiveness of all required regulatory submissions to be filed by OCC and NSCC with the appropriate regulatory authorities. Similar to the Existing Accord, the proposed New Accord would remain in effect (a) until it is terminated by the mutual written agreement of OCC and NSCC, (b) until it is unilaterally terminated by either clearing agency upon one year's written notice (as opposed to six months under the Existing Accord), or (c) until it is terminated by either NSCC or OCC upon the bankruptcy or insolvency of the other, provided that the election to terminate is communicated to the other party within three business days by written notice.

Under the proposed New Accord, NSCC would agree to notify OCC if NSCC ceases to act for a Common Member pursuant to the NSCC Rules no later than the earlier of NSCC's

provision of notice of such action to the governmental authorities or notice to other NSCC Members. Furthermore, if an NSCC Member for which NSCC has not yet ceased to act fails to satisfy its Clearing Fund obligations to NSCC, NSCC would be required to notify OCC promptly after discovery of the failure. Likewise, OCC would be required to notify NSCC of the suspension of a Common Member no later than the earlier of OCC's provision of notice to the governmental authorities or other OCC Clearing Members.

Under the Existing Accord, NSCC and OCC agree to share certain reports and information regarding settlement activity and obligations under the agreement. The New Accord would enhance this information sharing between the clearing agencies. Specifically, NSCC and OCC would agree to share certain information, including general risk management due diligence regarding Common Members, lists of Common Members, and information regarding the amounts of Common Members' margin and settlement obligations at OCC or Clearing Fund Required Deposits at NSCC. NSCC and OCC would also be required to provide the other clearing agency with any other information that the other reasonably requests in connection with the performance of its obligations under the New Accord. All such information would be required to be kept confidential, using the same care and discretion that each clearing agency uses for the safekeeping of its own members' confidential information. NSCC and OCC would each be required to act in good faith to resolve and notify the other of any errors, discrepancies or delays in the information it provides.

The New Accord also would include new terms to provide that, to the extent one party is

unable to perform any obligation as a result of the failure of the other party to perform its responsibilities on a timely basis, the time for the non-failing party's performance would be extended, its performance would be reduced to the extent of any such impairment, and it would not be liable for any failure to perform its obligations. Further, NSCC and OCC would agree that neither party would be liable to the other party in connection with its performance of its obligations under the proposed New Accord to the extent it has acted, or omitted or ceased to act, with the permission or at the direction of a governmental authority. Moreover, the proposed New Accord would provide that in no case would either clearing agency be liable to the other for punitive, incidental or consequential damages. The purpose of these new provisions is to provide clear and specific terms regarding each clearing agency's liability for non-performance under the agreement.

The proposed New Accord would also contain the usual and customary representations and warranties for an agreement of this type, including representations as to the parties' good standing, corporate power and authority and operational capability, that the agreement complies with laws and all government documents and does not violate any agreements, and that all of the required regulatory notifications and filings would be obtained prior to the New Accord's effective date. It would also include representations that the proposed New Accord constitutes a legal, valid and binding obligation on each of OCC and NSCC and is enforceable against each, subject to standard exceptions. Furthermore, the proposed New Accord would contain a force majeure provision, under which NSCC and OCC would agree to notify the other no later than

two hours upon learning that a force majeure event has occurred and both parties would be required to cooperate in good faith to mitigate the effects of any resulting inability to perform or delay in performing.

### **Proposed Amendments to OCC's By-Laws and Rules**

Given the key differences between the Existing Accord and the New Accord, as described above, OCC proposes certain changes to its By-Laws and Rules in order to accommodate the terms of the New Accord. The primary purpose of the proposed changes is to: (1) reflect the expanded scope of the New Accord, (2) reflect changes related to the new Guaranty Substitution mechanics of the New Accord; and (3) make other changes necessary to conform to the terms of the New Accord or to otherwise provide additional clarity around the settlement and margining<sup>18</sup> treatment of: (i) Eligible Securities under the New Accord, (ii) non-regular way securities settling through the facilities of NSCC but outside of the New Accord, and (iii) those securities settling outside of the New Accord and away from NSCC on a broker-to-broker basis. These proposed changes are discussed in greater detail below.

#### *Changes Related to the Expanded Scope of the New Accord*

First, OCC proposes to amend and replace the defined term "CNS-eligible"<sup>19</sup> in order to

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<sup>18</sup> OCC notes that, while it is proposing changes to its Rules concerning margin requirements (e.g., which transactions would be included as part of OCC's margin calculation at a given point in time), OCC is not proposing any changes to its margin model (with the exception that OCC would no longer collect and hold margin for positions after NSCC's Guaranty has taken effect under the New Accord).

<sup>19</sup> See Article I, Section (C)(23) of OCC's By-Laws.

reflect the expanded definition of Eligible Securities under the New Accord. The term “CNS-eligible” currently describes the securities underlying the physically-settled stock options that are eligible under the Existing Accord to be settled through NSCC’s CNS Accounting Operation. Under the New Accord, however, the term Eligible Securities is more broadly defined to include securities (both Stock Options and Stock Futures) eligible for settlement via NSCC’s CNS Accounting Operation and NSCC’s Balance Order Accounting Operation. Accordingly, OCC proposes to use “CCC,” for “correspondent clearing corporation”<sup>20</sup> to describe the Eligible Securities. Thus, the term “CCC-eligible” would replace “CNS-eligible” throughout OCC’s By-Laws and Rules.

Next, because the New Accord would include the settlement of Stock Futures, OCC proposes to make several changes to its rules regarding Stock Futures to accommodate this expansion. More specifically, OCC proposes a conforming amendment to Rule 901 Interpretation and Policy (.02) to clarify that, under the New Accord, OCC will, subject to its discretion, cause the settlement of all matured Stock Futures to be made through the facilities of NSCC to the extent that the underlying securities are CCC-eligible as the term is currently proposed.

OCC also proposes clarifying and conforming revisions to newly renumbered Rule

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<sup>20</sup> Under Article I of OCC’s By-Laws, the term "correspondent clearing corporation" means the National Securities Clearing Corporation or any successor thereto which, by agreement with the Corporation, provides facilities for settlements in respect of exercised option contracts or BOUNDS or in respect of delivery obligations arising from physically-settled stock futures.

901(e) (currently Rule 901(d)) to specify that settlements made through the facilities of the correspondent clearing corporation are governed by Rule 901 and to clarify that, under the New Accord, specifications made in any Delivery Advice may be revoked up until the point at which NSCC's Guaranty has taken effect (the "obligation time" as discussed below) and not the opening of business on the delivery date.

*Changes Related to Guaranty Substitution*

OCC also proposes a series of amendments to its Rules to accurately reflect the process under which the Guaranty Substitution occurs under the New Accord. First, OCC proposes to amend Rule 901(c) so that the term "obligation time" -- the time that the correspondent clearing corporation becomes unconditionally obligated, in accordance with its rules, to effect settlement in respect thereof or to close out the securities contract arising therefrom -- is synonymous with the Guaranty Substitution Time under the New Accord and (i.e., (i) settlement obligations are reported to and are not rejected by NSCC; (ii) NSCC has not notified OCC that it has ceased to act for the relevant Clearing Member; and (iii) the Clearing Fund requirements of the relevant Clearing Member are received by NSCC). Under the New Accord, if a default occurs prior to the Guaranty Substitution Time, the Guaranty Substitution will not occur for any E&A/Delivery Transactions involving the Defaulting NSCC Member, and OCC will continue to guarantee settlement for those Defaulted NSCC Member Transactions.

Next, OCC proposes to amend language in newly renumbered Rule 901(i) (currently Rule 901(h)) regarding the timing of the end of a Clearing Member's obligations to OCC with

respect to securities to be settled through NSCC. Under the Existing Accord and OCC's existing Rules, a Clearing Member's obligations to OCC end only once settlement is completed. Under the New Accord, however, a Clearing Member's obligations to OCC will end when OCC's obligations with respect to guaranteeing settlement of the security would end (*i.e.*, the Guaranty Substitution Time or "obligation time"). OCC therefore proposes to amend newly renumbered Rule 901(i) to specify that a Clearing Member's obligations to OCC will be deemed completed and performed once the "obligation time" has occurred.

As discussed above, the New Accord eliminates the provisions of the Existing Accord whereby OCC and NSCC guaranteed each other the performance of Common Members and made certain payments to the other upon the default of a Common Member. As such, OCC proposes to delete discussions of such guarantees and payments from newly renumbered Rule 901(i) and Rule 1107.

OCC also proposes amendments to Rules 910 and 911, which set forth procedures for handling failures to make or take delivery of securities in settlement of exercised or assigned Stock Options and matured physically-settled Stock Futures, to add language to both rules to clarify that the failure procedures set forth therein would not apply with respect to any delivery to be made through NSCC pursuant to Rule 901. Under the New Accord, once the Guaranty Substitution Time with respect to a specific E&A/Delivery Transaction occurs, OCC's Guaranty ends and NSCC's Guaranty begins, leaving OCC with no involvement with or responsibility for the settlement of the securities underlying that transaction. Therefore, if there is a failure to



make or take delivery with respect to that transaction after Guaranty Substitution has occurred, the NSCC Rules will govern that failure. With respect to deliveries made on a broker-to-broker basis under OCC Rules 903 through 912 (including those that may utilize NSCC's Obligation Warehouse services), and which are not governed by Rule 901, Guaranty Substitution does not occur and OCC's failure procedures would apply.

*Changes to OCC's Margin Rules*

Under the New Accord, OCC will no longer collect margin on a transaction once it is no longer guaranteeing settlement for that transaction. As such, OCC proposes to add language to Rule 601(f) to clarify that OCC's margin calculations will not include delivery obligations arising from any Stock Options or Stock Futures that are eligible for settlement through NSCC and for which OCC has no further settlement obligations because either (i) Guaranty Substitution has occurred for E&A/Delivery Transactions under the New Accord (as described in revised Rule 901(c)) or (ii) NSCC has otherwise accepted transactions for non-regular way settlement under the NSCC Rules (as describe in newly proposed Rule 901(d)).<sup>21</sup> By not including these transactions as part of OCC's margin calculation, OCC is hoping to alleviate instances of "double-margining" for Common Members that may otherwise simultaneously owe margin to NSCC and OCC with respect to the same position.

OCC also proposes to delete Rule 608A in its entirety. The New Accord seeks to

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<sup>21</sup> Related revisions to Rule 901(c) and newly proposed Rule 901(d) are discussed in more detail below.

eliminate the situation under the Existing Accord where Common Members are effectively “double-margined” or required to simultaneously post margin with OCC and NSCC with respect to the same position. As the New Accord eliminates this double-margining scenario, Rule 608A, which provides procedures pursuant to which a Clearing Member could use the securities deposited as margin with OCC as collateral to secure a loan to pay its margin obligations to NSCC, is now unnecessary.

*Other Clarifying Changes Not Related to the New Accord*

OCC also proposes to amend its Rules to make clarifying changes that are not directly required by the New Accord but would provide additional clarity in its Rules in light of other changes being made to accommodate the New Accord. Specifically, OCC proposes to revise Rule 901 Interpretation and Policy (.02) to provide that transactions that involve the delivery of non-CCC eligible securities made on a broker-to-broker basis (and away from NSCC) may nevertheless involve the use of certain services of NSCC (*e.g.*, NSCC’s Obligation Warehouse). For such transactions, because they are not covered by the New Accord and NSCC at no point guarantees settlement, OCC Rule 901 would not apply and delivery is governed by the broker-to-broker settlement procedures set forth in OCC Rules 903 through 912, as is the case currently today. Additionally, while OCC’s existing Rules do not prohibit broker-to-broker settlements from being facilitated through the services of a correspondent clearing corporation, they do not explicitly contemplate the possibility. OCC also proposes to make clarifying amendments to Rule 904(b) and 910A(a) to more clearly distinguish between settlements effected through

NSCC's CNS Accounting Operation or Balance Order Accounting Operations in accordance with OCC Rule 901 and deliveries effected on a broker-to-broker basis utilizing services of NSCC under OCC Rules 903 through 912 and to clearly state which OCC Rules apply in each context.

Further, OCC proposes to add a new paragraph (d) to Rule 901 to clarify that OCC still intends, at its discretion, to effect settlement of Stock Options and Stock Futures that are scheduled to be settled on the first business day after exercise or maturity through NSCC pursuant to Rule 901 and the relevant provisions of the NSCC Rules, even though such contracts are outside the scope of the New Accord. These contracts would continue to be settled as they are currently today.

OCC also proposes clarifying and conforming changes to the introductory language of Chapter IX of the Rules. Specifically, OCC proposes conforming changes to the Rule to reflect the replacement of the defined term "CNS-eligible" with "CCC-eligible" as described above. The proposed changes would also clarify that OCC's broker-to-broker settlement rules are contained in Rules 903-912, as Rule 902 concerns Delivery Advices, which also may be applicable to settlements made through the correspondent clearing corporation pursuant to Rule 901. In addition, the proposed changes to the introductory language of Chapter IX of the Rules would provide additional clarity around OCC's existing authority to alter a previous designation of a settlement method at any time prior to the designated delivery date by specifying that this authority would apply to both settlements to be made through the facilities of the correspondent

clearing corporation pursuant to Rule 901 or settlements to be made on a broker-to-broker basis pursuant to Rules 903 through 912. Finally, OCC proposes a number of conforming changes to Rules 901 and 912 to reflect the renumbering of various Rule provisions due to the proposed amendments described above.

B. Statutory Basis

Section 17A(b)(3)(F) of the Securities Exchange Act of 1934 (“Act”), requires, in part, that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions, to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible, and to foster cooperation and coordination with persons engaged in the clearance and settlement of securities transactions.<sup>22</sup> OCC believes that the proposed rule change is consistent with the requirements of Section 17A(b)(3)(F) of the Act<sup>23</sup> and the rules thereunder applicable to OCC for the reasons set forth below.

In connection with the proposal to enhance the timing of the Guaranty Substitution, the proposed New Accord, and related changes to OCC’s By-Laws and Rules, would establish clear, transparent, and enforceable terms for the settlement of OCC’s cleared Stock Options and Stock Futures through the facilities of NSCC. Specifically, the New Accord would continue to provide a sound framework for the settlement of certain Stock Options issued and cleared by OCC

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<sup>22</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>23</sup> Id.

through the facilities of NSCC and would extend this framework to a clearly defined scope of additional Stock Options and Stock Futures transactions. In addition, the proposed rule change would simplify the settlement process for those Stock Options currently settled under the Existing Accord by clarifying the timing and mechanisms by which OCC's guaranty ends and NSCC's guaranty begins by focusing on the timing of the Guaranty Substitution, as described in detail above. By clarifying and simplifying the settlement process for these transactions, the New Accord would operate to minimize the risk of interruptions to clearing agency operations in the event of a Common Member default, and, in this way, would promote the prompt and accurate clearance and settlement of securities transactions.

In addition, by eliminating any ambiguity regarding which clearing agency is responsible for guaranteeing settlement at any given moment, the proposal to enhance the timing of the Guaranty Substitution would provide greater certainty that in the event of a Common Member default, the default would be handled pursuant to the rules and procedures of the clearing agency whose guarantee is then in effect and the system for the clearance and settlement of Stock Options and Stock Futures would continue with minimal interruption. This greater certainty would strengthen OCC's and NSCC's ability to plan for and manage, and therefore would mitigate, the risk presented by Common Member defaults. It would also minimize the "double margining" issue that occurs under the Existing Accord so that Common Members would no longer be required to post margin at both clearing agencies to cover the same E&A/Delivery Transactions, thereby reducing their potential exposures across multiple clearing agencies for the

same positions. In this way, the New Accord is designed to safeguard the securities and funds which are in the custody or control of OCC or for which it is responsible.

The proposals to expand the category of securities eligible for settlement and guarantee and to apply uniform treatment to standard and non-standard options under the New Accord would provide consistent treatment across all expiries for products with regular way settlement cycle specifications, and would promote the prompt and accurate clearance and settlement of these additional securities transactions.

In connection with the proposal to enhance the information sharing arrangement between NSCC and OCC, NSCC and OCC would agree to share certain information, including general risk management due diligence regarding Common Members, lists of Common Members, and information regarding the amounts of Common Members' margin and settlement obligations at OCC or Clearing Fund Required Deposits at NSCC. In this way, the New Accord would foster cooperation and coordination between OCC and NSCC in the settlement of securities transactions.

Finally, other proposed changes to OCC's Rules would provide additional clarity, transparency, and certainty around the settlement and margining treatment of various securities transactions cleared by OCC (including those settled under the New Accord, those otherwise settled through the facilities of NSCC, and those that settle on a broker-to-broker basis away from NSCC). By providing its Clearing Members with this additional clarity, transparency, and certainty in OCC's Rules, the proposed rule change would promote the prompt and accurate

clearance and settlement of securities transactions and the safeguarding of securities and funds which are in the custody or control of OCC or for which it is responsible

Therefore, for the reasons stated above, OCC believes that the proposed rule change is consistent with the requirements of Section 17A(b)(3)(F) of the Act.<sup>24</sup>

Rule 17Ad-22(e)(1) under the Act requires that a covered clearing agency 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.<sup>25</sup> The New Accord would constitute a legal, valid and binding obligation on each of OCC and NSCC, which is enforceable against each clearing agency. In connection with the proposal to enhance the timing of the Guaranty Substitution, the New Accord would establish clear, transparent, and enforceable terms for the settlement of OCC's cleared Stock Options and Stock Futures through the facilities of NSCC and would simplify the settlement process for those Stock Options currently settled under the Existing Accord. By clarifying the timing and mechanisms by which OCC's Guaranty ends and NSCC's Guaranty begins by focusing on the timing of the Guaranty Substitution, the new Accord, specifically the proposal to enhance the timing of the Guaranty Substitution, would provide a clear, transparent and enforceable legal basis for OCC's and NSCC's obligations during the event of a Common Member default. As a result, OCC believes that the proposal is consistent with the requirements

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<sup>24</sup> Id.

<sup>25</sup> 17 CFR 240.17Ad-22(e)(1).

of Rule 17Ad-22(e)(1).<sup>26</sup>

Rule 17Ad-22(e)(20) under the Act requires, in part, that a covered clearing agency establish, implement, maintain and enforce written policies and procedures reasonably designed to identify, monitor, and manage risks related to any link the covered clearing agency establishes with one or more other clearing agencies or financial market utilities.<sup>27</sup>

OCC is proposing to adopt the New Accord in order to address the risks it has identified related to its existing link with the NSCC within the Existing Accord. Specifically, under the terms of the Existing Accord, even after NSCC's guarantee has come into effect, OCC is not released from its guarantee with respect to the Options E&A until certain deadlines have passed on the first business day following the scheduled settlement date without NSCC notifying OCC that the relevant Common Member has failed to meet an obligation to NSCC and/or NSCC has ceased to act for such firm. This current process results in a period of time where NSCC's trade guarantee and OCC's guarantee both apply to the same positions, and, therefore, both clearing agencies are holding margin against the same Options E&A position. As a result, the Existing Accord provides for a more complicated framework for the settlement of certain Stock Options. These complications could give rise to inconsistencies with regard to the development and application of interdependent policies and procedures between OCC and NSCC, which could lead to unanticipated disruptions in OCC's or NSCC's clearing operations.

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<sup>26</sup> Id.

<sup>27</sup> 17 CFR 240.17Ad-22(e)(20).



In connection with the proposal to enhance the timing of the Guaranty Substitution, the New Accord would provide for a clearer, simpler framework for the settlement of certain Stock Options and Stock Futures by pinpointing a specific moment in time, the Guaranty Substitution Time, at which guarantee obligations would transfer from OCC to NSCC. The New Accord would eliminate any ambiguity regarding which clearing agency is responsible for guaranteeing settlement at any given moment. Establishing a precise Guaranty Substitution Time would also provide greater certainty that in the event of a Common Member default, the default would be handled pursuant to the rules and procedures of the clearing agency whose guarantee is then in effect and the system for the clearance and settlement of Stock Options and Stock Futures would continue with minimal interruption. This greater certainty would strengthen OCC's and NSCC's ability to plan for and manage, and therefore would mitigate, the risk presented by Common Member defaults to OCC and NSCC, other members, and the markets the clearing agencies serve. Therefore, through the adoption of the proposal to enhance the timing of the Guaranty Substitution, OCC would more effectively manage its risks related to the operation of the New Accord.

Moreover, in connection with the proposal to put additional arrangements into place concerning the procedures, information sharing, and overall governance processes under the New Accord, NSCC and OCC would agree to share certain information, including general surveillance information regarding their members, so that each clearing agency would be able to effectively identify, monitor, and manage risks that may be presented by certain Common

Members. Accordingly, OCC believes the proposed changes are reasonably designed to identify, monitor, and manage risks related to the link established between OCC and NSCC for the settlement of certain Stock Options and Stock Futures in a manner consistent with Rule 17Ad-22(e)(20).<sup>28</sup>

Finally, Rule 17Ad-22(e)(21) under the Act requires that a covered clearing agency establish, implement, maintain and enforce written policies and procedures reasonably designed to, among other things, be efficient and effective in meeting the requirements of its participants and the markets it serves.<sup>29</sup> As noted above, under the Existing Accord, even after NSCC's guarantee has come into effect, OCC is not released from its guarantee with respect to the Options E&A until certain deadlines have passed on the first business day following the scheduled settlement date without NSCC notifying OCC that the relevant Common Member has failed to meet an obligation to NSCC and/or NSCC has ceased to act for such firm. This results in a period of time where NSCC's guarantee overlaps with OCC's guarantee and where both clearing agencies are holding margin against the same Options E&A positions. In connection with the proposal to enhance the timing of the Guaranty Substitution, the New Accord would minimize this "double margining" issue by introducing a new Guaranty Substitution Time, which would normally occur as soon as NSCC has received all Required Deposits to the Clearing Fund from Common Members, which have been calculated taking into account the

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<sup>28</sup> Id.

<sup>29</sup> 17 CFR 240.17Ad-22(e)(21).

relevant E&A/Delivery Transactions, rather than require reimbursement payments from one clearing agency to the other. As a result, Common Members would no longer be required to post margin at both clearing agencies to cover the same E&A/Delivery Transactions. OCC believes that, by simplifying the terms of the existing agreement in this way, the New Accord is designed to be efficient and effective in meeting the requirements of OCC's and NSCC's participants and the markets they serve.

Additionally, the proposal to put additional arrangements into place concerning the procedures, information sharing, and overall governance processes under the New Accord would create new efficiencies in the management of this important link between OCC and NSCC. The proposal to enhance information sharing between OCC and NSCC would allow the clearing agencies to more effectively identify, monitor, and manage risks that may be presented by certain Common Members, and would create new efficiencies in their general surveillance efforts with respect to these firms.

In these ways, OCC believes the proposed New Accord is consistent with the requirements of Rule 17Ad-22(e)(21).<sup>30</sup>

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

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Id.

**Item 4. Self-Regulatory Organization's Statement on Burden on Competition**

Section 17A(b)(3)(I) of the Act<sup>31</sup> requires that the rules of a clearing agency not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. OCC does not believe the proposed rule change would have any impact or impose any burden on competition. The primary purpose of the proposed rule change is to adopt a clearer, simpler framework for the settlement of Stock Options issued by OCC and settled through the facilities of NSCC through the introduction of a new Guaranty Substitution Time. The proposed New Accord would also extend this framework to both (1) Stock Options contracts in securities that are eligible to be settled through NSCC's Balance Order Accounting Operation and (2) certain delivery obligations arising from matured physically-settled Stock Futures contracts cleared by OCC that are eligible to be settled through NSCC's CNS Accounting Operation or Balance Order Accounting Operation. The New Accord would put additional arrangements into place concerning the procedures, information sharing, and overall governance processes under the agreement. OCC is also proposing to make certain clarifying and conforming changes to the OCC Rules as necessary to implement the New Accord or to otherwise provide more clarity in OCC's Rules. None of these proposed rule changes, either individually or together, would affect Common Members' access to OCC's services, nor would any of these proposed changes

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<sup>31</sup> 15 U.S.C. 78q-1(b)(3)(I).

disadvantage or favor any particular user in relationship to another user. As such, OCC believes that the proposed changes would not have any impact or impose any burden on competition.

**Item 5. Self-Regulatory Organization’s Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others**

Written comments were not and are not intended to be solicited with respect to the proposed rule change and none have been received. OCC will notify the Commission of any written comments received by OCC.

**Item 6. Extension of Time Period for Commission Action**

Not applicable.

**Item 7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2) or Section 19(b)(7)(D)**

- (a) Not applicable.
- (b) Not applicable.
- (c) Not applicable.
- (d) Not applicable.

**Item 8. Proposed Rule Change Based on Rule of Another Self-Regulatory Organization or of the Commission**

Not applicable.

**Item 9. Security-Based Swap Submissions Filed Pursuant to Section 3C of the Act**

Not applicable.

**Item 10. Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act**

Not applicable.

**Item 11.     Exhibits**

Exhibit 1A.   Completed Notice of Proposed Rule Change for publication in the Federal Register.

Exhibit 5A.   OCC By-Laws

Exhibit 5B.   OCC Rules

Exhibit 5C.   Stock Options and Futures Settlement Agreement [REDACTED]

**CONFIDENTIAL TREATMENT IS REQUESTED FOR EXHIBIT 5C**

**PURSUANT TO SEC RULE 24b-2**

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, The Options Clearing Corporation has caused this filing to be signed on its behalf by the undersigned hereunto duly authorized.

**THE OPTIONS CLEARING CORPORATION**

**By:** \_\_\_\_\_  
**Justin W. Byrne**  
**Vice President, Regulatory Filings**

EXHIBIT 1A

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-[\_\_\_\_\_]; File No. SR-OCC-2017-013)

June 1, 2017

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of Proposed Rule Change Concerning the Adoption of a New Stock Options and Futures Settlement Agreement Between The Options Clearing Corporation and the National Securities Clearing Corporation

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on June 1, 2017, The Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II and III below, which Items have been prepared primarily by OCC. 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 is filed in connection with proposed changes relating to a new Stock Options and Futures Settlement Agreement (“New Accord”) between OCC and the National Securities Clearing Corporation (“NSCC,” collectively NSCC and OCC may be referred to herein as the “clearing agencies”) and amendments to OCC’s By-Laws and Rules to accommodate the proposed provisions of the New Accord.

The proposed changes to OCC’s By-Laws and Rules and the proposed New Accord were attached as Exhibits 5A - 5C of the filing, respectively.<sup>3</sup> The proposed

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

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

<sup>3</sup> OCC has filed an advance notice with the Commission in connection with the



changes are described in detail in Item 3 below. All terms with initial capitalization not defined herein have the same meaning as set forth in OCC's By-Laws and Rules.<sup>4</sup>

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

**Background**

OCC issues and clears U.S.-listed options and futures on a number of underlying financial assets including common stocks, currencies and stock indices. OCC's Rules, however, provide that delivery of, and payment for, securities underlying certain physically settled stock options and single stock futures cleared by OCC are effected through the facilities of a correspondent clearing corporation (i.e., NSCC) and are not

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New Accord. See SR-OCC-2017-804. NSCC also has filed proposed rule change and advance notice filings with the Commission in connection with the New Accord. See NSCC filings SR-NSCC-2017-007 and SR-NSCC-2017-803, respectively.

<sup>4</sup> OCC's By-Laws and Rules can be found on OCC's public website: <http://optionsclearing.com/about/publications/bylaws.jsp>. Other terms not defined herein or in the OCC By-Laws and Rules can be found in the Rules & Procedures of NSCC ("NSCC Rules"), available at [http://www.dtcc.com/~media/Files/Downloads/legal/rules/nscc\\_rules.pdf](http://www.dtcc.com/~media/Files/Downloads/legal/rules/nscc_rules.pdf), as the context implies.

settled through the facilities OCC. OCC and NSCC are parties to a Third Amended and Restated Options Exercise Settlement Agreement, dated February 16, 1995, as amended (“Existing Accord”),<sup>5</sup> which governs the delivery and receipt of stock in the settlement of put and call options issued by OCC (“Stock Options”) that are eligible for settlement through NSCC’s Continuous Net Settlement (“CNS”) Accounting Operation and are designated to settle on the third business day following the date the related exercise or assignment was accepted by NSCC (“Options E&A”). All OCC Clearing Members that intend to engage in Stock Options transactions are required to also be Members of NSCC or to have appointed or nominated an NSCC Member to act on its behalf.<sup>6</sup>

OCC proposes to adopt a New Accord with NSCC, which would provide for the settlement of certain Stock Options and delivery obligations arising from certain matured physically-settled stock futures contracts cleared by OCC (“Stock Futures”). Specifically, the New Accord would, among other things: (1) expand the category of

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<sup>5</sup> The Existing Accord and the proposed changes thereunder were previously approved by the Commission. See Securities Exchange Act Release No. 37731 (September 26, 1996), 61 FR 51731 (October 3, 1996) (SR-OCC-96-04 and SR-NSCC-96-11) (Order Approving Proposed Rule Change Related to an Amended and Restated Options Exercise Settlement Agreement Between the Options Clearing Corporation and the National Securities Clearing Corporation); Securities Exchange Act Release No. 43837 (January 12, 2001), 66 FR 6726 (January 22, 2001) (SR-OCC-00-12) (Order Granting Accelerated Approval of a Proposed Rule Change Relating to the Creation of a Program to Relieve Strains on Clearing Members’ Liquidity in Connection With Exercise Settlements); and Securities Exchange Act Release No. 58988 (November 20, 2008), 73 FR 72098 (November 26, 2008) (SR-OCC-2008-18 and SR-NSCC-2008-09) (Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Changes Relating to Amendment No. 2 to the Third Amended and Restated Options Exercise Settlement Agreement).

<sup>6</sup> A firm that is both an OCC Clearing Member and an NSCC Member, or is an OCC Clearing Member that has designated an NSCC Member to act on its behalf is referred to herein as a “Common Member.”

securities that are eligible for settlement and guaranty under the agreement to certain securities (including stocks, exchange-traded funds and exchange-traded notes) that (i) are required to be delivered in the exercise and assignment of Stock Options and are eligible to be settled through NSCC's Balance Order Accounting Operation (in addition to its CNS Accounting Operation) or (ii) are delivery obligations arising from Stock Futures that have reached maturity and are eligible to be settled through NSCC's CNS Accounting Operation or Balance Order Accounting Operation; (2) modify the time of the transfer of responsibilities from OCC to NSCC and, specifically, when OCC's guarantee obligations under OCC's By-Laws and Rules with respect to such transactions ("OCC's Guaranty") end and NSCC's obligations under Addendum K of the NSCC Rules with respect to such transactions ("NSCC's Guaranty") begin (such transfer being the "Guaranty Substitution"); and (3) put additional arrangements into place concerning the procedures, information sharing, and overall governance processes under the agreement. Furthermore, OCC proposes to make certain clarifying and conforming changes to the OCC By-Laws and Rules as necessary to implement the New Accord.

The primary purpose of the proposed changes is to (1) provide consistent treatment across all expiries for products with "regular way"<sup>7</sup> settlement cycle

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<sup>7</sup> Under the New Accord, "regular way settlement" shall have a meaning agreed to by the clearing agencies. Generally, regular way settlement is understood to be the financial services industry's standard settlement cycle. Currently, regular way settlement of Stock Options or Stock Futures transactions are those transactions designated to settle on the third business day following the date the related exercise, assignment or delivery obligation was accepted by NSCC. NSCC has proposed to change the NSCC Rules with respect to the meaning of regular way settlement in order to be consistent with the anticipated industry-wide move to a shorter standard settlement cycle of two business days after trade date. See Securities Exchange Act Release No. 79734 (January 4, 2017), 82 FR 3030 (January 10, 2017) (SR-NSCC-2016-007). See also Securities Exchange Act

specifications; (2) reduce the operational complexities of the Existing Accord by eliminating the cross-guaranty between OCC and NSCC and the bifurcated risk management of exercised and assigned transactions between the two clearing agencies by delineating a single point in time at which OCC's Guaranty ceases and NSCC's Guaranty begins; (3) further solidify the roles and responsibilities of OCC and NSCC in the event of a default of a Common Member at either or both clearing agencies; and (4) improve procedures, information sharing, and overall governance under the agreement.

The New Accord would become effective, and wholly replace the Existing Accord, at a date specified in a service level agreement to be entered into between NSCC and OCC.<sup>8</sup>

### **The Existing Accord**

#### *Key Terms of the Existing Accord*

Under the Existing Accord, the settlement of Options E&A generally proceeds according to the following sequence of events. NSCC maintains and delivers to OCC a list ("CNS Eligibility Master File") that enumerates all CNS Securities, which are defined in NSCC's Rule 1 and generally include securities that have been designated by NSCC as eligible for processing through NSCC's CNS Accounting Operation and eligible for book entry delivery at NSCC's affiliate, The Depository Trust Company (for purposes of this proposed rule change, such securities are referred to as "CNS Eligible Securities").<sup>9</sup>

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Release No. 78962 (September 28, 2016), 81 FR 69240 (October 5, 2016) (S7-22-16) (Amendment to Securities Transaction Settlement Cycle).

<sup>8</sup> Such effective date would be a date following approval of all required regulatory submissions to be filed by OCC and NSCC with the appropriate regulatory authorities, including this proposed rule change. See supra note 1.

<sup>9</sup> See supra note 2.

OCC, in turn, uses this file to make a final determination of which securities NSCC would not accept and therefore would need to be settled on a broker-to-broker basis. OCC then sends to NSCC a transactions file,<sup>10</sup> listing the specific securities that are to be delivered and received in settlement of an Options E&A that have not previously been reported to NSCC and for which settlement is to be made through NSCC (“OCC Transactions File”).<sup>11</sup> With respect to each Options E&A, the OCC Transactions File includes the CUSIP number of the security to be delivered, the identities of the delivering and receiving Common Members, the quantity to be delivered, the total value of the quantity to be delivered based on the exercise price of the option for which such security is the underlying security, and the exercise settlement date. After receiving the OCC Transactions File, NSCC then has until 11:00 AM Central Time on the following business day to reject any transaction listed in the OCC Transactions File. NSCC can reject a transaction if the security to be delivered has not been listed as a CNS Eligible Security in the CNS Eligible Master File or if information provided in the OCC Transactions File is incomplete. Otherwise, if NSCC does not so notify OCC of its rejection of an Options E&A by the time required under the Existing Accord, NSCC will become unconditionally obligated to effect settlement of the Options E&A.

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<sup>10</sup> Delivery of the OCC Transactions File with respect to an Options E&A typically happens on the date of the option’s exercise or expiration, though this is not expressly stated in the Existing Accord. In theory, however, an Options E&A could, due to an error or delay, be reported later than the date of the option’s exercise or expiration.

<sup>11</sup> This process would be substantially the same under the New Accord with the exception that the CNS Eligibility Master File and OCC Transactions File would be renamed and would be expanded in scope to include additional securities that would be eligible for guaranty and settlement under the New Accord, as discussed in further detail below.

Under the Existing Accord, even after NSCC's trade guarantee has come into effect,<sup>12</sup> OCC is not released from its guarantee with respect to the Options E&A until certain deadlines<sup>13</sup> have passed on the first business day following the scheduled settlement date without NSCC notifying OCC that the relevant Common Member has failed to meet an obligation to NSCC or NSCC has ceased to act for such Common Member pursuant to the NSCC Rules.<sup>14</sup> As a result, there is a period of time when NSCC's trade guarantee overlaps with OCC's guarantee and where both clearing agencies are holding margin against the same Options E&A position.

In the event that NSCC or OCC ceases to act on behalf of or suspends a Common Member, that Common Member becomes a "defaulting member." Once a Common Member becomes a defaulting member, the Existing Accord provides that NSCC will make a payment to OCC equal to the lesser of OCC's loss or the positive mark-to-market amount relating to the defaulting member's Options E&A and that OCC will make a payment to NSCC equal to the lesser of NSCC's loss or the negative mark-to-market amount relating to the defaulting member's Options E&A to compensate for potential

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<sup>12</sup> Pursuant to Addendum K of the NSCC Rules, NSCC guarantees the completion of CNS transactions and balance order transactions that have reached the point at which, for bi-lateral submissions by Members, such trades have been validated and compared by NSCC, and for locked-in submission, such trades have been validated by NSCC, as described in the NSCC Rules. Transactions that are covered by the Existing Accord, and that would be covered by the New Accord, are expressly excluded from the timeframes described in Addendum K. See supra note 2.

<sup>13</sup> The deadline is 6:00 AM Central Time for NSCC notifying OCC of a Common Member failure and, if NSCC does not immediately cease to act for such defaulting Common Member, 4:00 PM Central Time for notifying OCC that it has ceased to act.

<sup>14</sup> See NSCC Rule 46 (Rule 46 (Restrictions on Access to Services)). See supra note 2.

losses incurred in connection with the default. A clearing agency must request the transfer of any such payments by the close of business on the tenth business day following the day of default and, after a request is made, the other clearing agency is required to make payment within five business days of the request.

## **The New Accord**

### *Overview*

As noted above, NSCC proposes to adopt a New Accord with OCC, which would provide for the settlement of certain Stock Options and Stock Futures transactions. The New Accord is primarily designed to, among other things, expand the category of securities that are eligible for settlement and guaranty under the agreement; simplify the time of the transfer of responsibilities from OCC to NSCC (specifically, the transfer of guarantee obligations); and put additional arrangements into place concerning the procedures, information sharing, and overall governance processes under the agreement. The material provisions of the New Accord are described in detail below.

### *Key Elements of the New Accord*

#### Expanded Scope of Eligible Securities

Pursuant to the proposed New Accord, on each day that both OCC and NSCC are open for accepting trades for clearing (“Activity Date”), NSCC would deliver to OCC an “Eligibility Master File,” which would identify the securities, including stocks, exchange-traded funds and exchange-traded notes, that are (1) eligible to settle through NSCC’s CNS Accounting Operation (as is currently the case under the Existing Accord) or NSCC’s Balance Order Accounting Operation (which is a feature of the New Accord) and (2) to be delivered in settlement of (i) exercises and assignments of Stock Options (as

is currently the case under the Existing Accord) or (ii) delivery obligations arising from maturing physically settled Stock Futures (which is a feature of the New Accord) (all such securities collectively being “Eligible Securities”). OCC, in turn, would deliver to NSCC its file of E&A/Delivery Transactions<sup>15</sup> that list the Eligible Securities to be delivered, or received, and for which settlement is proposed to be made through NSCC on that Activity Date. Guaranty Substitution (discussed further below) would not occur with respect to an E&A/Delivery Transaction that is not submitted in the proper format or that involves a security that is not identified as an Eligible Security on the then-current Eligibility Master File. This process is similar to the current process under the Existing Accord with the exception of the expanded scope of Eligible Securities (and additional fields necessary to accommodate such securities) that would be listed on the Eligibility Master File and the E&A/Delivery Transactions file.

Like the Existing Accord, the proposed New Accord would continue to facilitate the processes by which Common Members deliver and receive stock in the settlement of Stock Options that are eligible to settle through NSCC’s CNS Accounting Operation and are designated to settle regular way. The New Accord would also expand the category of securities eligible for settlement under the agreement. In particular, the New Accord would facilitate the processes by which Common Members deliver and receive stock in

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<sup>15</sup> “E&A/Delivery Transactions” are transactions involving the settlement of Stock Options and Stock Futures under the New Accord. The delivery of E&A/Delivery Transactions to NSCC would replace the delivery of the “OCC Transactions File” from the Existing Accord. The actual information delivered by OCC to NSCC would be the same as is currently provided on the OCC Transactions File, but certain additional terms would be included to accommodate the inclusion of Stock Futures, along with information regarding the date that the instruction to NSCC was originally created and the E&A/Delivery Transaction’s designated settlement date.



settlement of Stock Futures that are eligible to settle through NSCC's CNS Accounting Operation and are designated to settle regular way. It would also provide for the settlement of both Stock Options and Stock Futures that are eligible to settle through NSCC's Balance Order Accounting Operation on a regular way basis. The primary purpose of expanding the category of securities that are eligible for settlement and guaranty under the agreement is to provide consistent treatment across all expiries for products with regular way settlement cycle specifications and simplify the settlement process for these additional securities transactions.

The New Accord would not apply to Stock Options or Stock Futures that are designated to settle on a shorter timeframe than the regular way settlement timeframe. These Stock Options would continue to be processed and settled as they would be today, outside of the New Accord. The New Accord also would not apply to any Stock Options or Stock Futures that are neither CNS Securities nor Balance Order Securities.<sup>16</sup> Transactions in these securities are, and would continue to be, processed on a trade-for-trade basis away from NSCC's facilities. Such transactions may utilize other NSCC services for which they are eligible, but would not be subject to the New Accord.<sup>17</sup>

#### Proposed Changes Related to Guaranty Substitution

The New Accord would adopt a fundamentally different approach to the delineation of the rights and responsibilities of OCC and NSCC with respect to

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<sup>16</sup> Balance Order Securities are defined in NSCC Rule 1, and are generally securities, other than foreign securities, that are eligible to be cleared at NSCC but are not eligible for processing through the CNS Accounting Operation. See supra note 2.

<sup>17</sup> OCC will continue to guarantee settlement until settlement actually occurs with respect to these Stock Options and Stock Futures.

E&A/Delivery Transactions. The purpose of the proposed changes related to the Guaranty Substitution, defined below, is to reduce the operational complexities of the Existing Accord by eliminating the cross-guaranty between OCC and NSCC and the bifurcated risk management of exercised and assigned transactions between the two clearing agencies and delineating a single point in time at which OCC's Guaranty ceases and NSCC's Guaranty begins. Moreover, the proposed changes would solidify the roles and responsibilities of OCC and NSCC in the event of a default of a Common Member at either or both clearing agencies.

As described above, the Existing Accord provides that NSCC will make a payment to OCC following the default of a Common Member in an amount equal to the lesser of OCC's loss or the positive mark-to-market amount relating to the Common Member's Options E&A, and provides that OCC will make a payment to NSCC following the default of a Common Member equal to the lesser of NSCC's loss or the negative mark-to-market amount relating to the Common Member's Options E&A to compensate for potential losses incurred in connection with the Common Member's default. The proposed New Accord, in contrast, would focus on the transfer of responsibilities from OCC to NSCC and, specifically, the point at which OCC's Guaranty ends and NSCC's Guaranty begins (i.e., the Guaranty Substitution) with respect to E&A/Delivery Transactions. By focusing on the timing of the Guaranty Substitution, rather than payment from one clearing agency to the other, the New Accord would simplify the agreement and the procedures for situations involving the default of a Common Member. The New Accord additionally would minimize "double-margining" situations when a Common Member may simultaneously owe margin to both NSCC and

OCC with respect to the same E&A/Delivery Transaction.

After NSCC has received an E&A/Delivery Transaction, the Guaranty Substitution would normally occur when NSCC has received all Required Deposits to its Clearing Fund, calculated taking into account such E&A/Delivery Transaction, of Common Members (“Guaranty Substitution Time”).<sup>18</sup> At the Guaranty Substitution Time, NSCC’s Guaranty takes effect, and OCC does not retain any settlement obligations with respect to such E&A/Delivery Transactions. The Guaranty Substitution would not occur, however, with respect to any E&A/Delivery Transaction if NSCC has rejected such E&A/Delivery Transaction due to an improper submission, as described above, or if, during the time after NSCC’s receipt of the E&A/Delivery Transaction but prior to the Guaranty Substitution Time, a Common Member involved in the E&A/Delivery Transaction has defaulted on its obligations to NSCC by failing to meet its Clearing Fund obligations, or NSCC has otherwise ceased to act for such Common Member pursuant to the NSCC Rules (in either case, such Common Member becomes a “Defaulting NSCC Member”).

NSCC would be required to promptly notify OCC if a Common Member becomes a Defaulting NSCC Member, as described above. Upon receiving such a notice, OCC would not submit to NSCC any further E&A/Delivery Transactions involving the Defaulting NSCC Member for settlement, unless authorized representatives of both OCC and NSCC otherwise consent. OCC would, however, deliver to NSCC a list of all E&A/Delivery Transactions that have already been submitted to NSCC and that involve

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<sup>18</sup> Procedure XV of the NSCC Rules provides that all Clearing Fund requirements and other deposits must be made within one hour of demand, unless NSCC determines otherwise. See supra note 2.

the Defaulting NSCC Member (“Defaulted NSCC Member Transactions”). The Guaranty Substitution ordinarily would not occur with respect to any Defaulted NSCC Member Transactions, unless both clearing agencies agree otherwise. As such, NSCC would have no obligation to guaranty such Defaulted NSCC Member Transactions, and OCC would continue to be responsible for effecting the settlement of such Defaulted NSCC Member Transactions pursuant to OCC’s By-Laws and Rules. Once NSCC has confirmed the list of Defaulted NSCC Member Transactions, Guaranty Substitution would occur for all E&A/Delivery Transactions for that Activity Date that are not included on such list. NSCC would be required to promptly notify OCC upon the occurrence of the Guaranty Substitution Time on each Activity Date.

If OCC suspends a Common Member after NSCC has received the E&A/Delivery Transactions but before the Guaranty Substitution has occurred, and that Common Member has not become a Defaulting NSCC Member, the Guaranty Substitution would proceed at the Guaranty Substitution Time. In such a scenario, OCC would continue to be responsible for guaranteeing the settlement of the E&A/Delivery Transactions in question until the Guaranty Substitution Time, at which time the responsibility would transfer to NSCC. If, however, the suspended Common Member also becomes a Defaulting NSCC Member after NSCC has received the E&A/Delivery Transactions but before the Guaranty Substitution has occurred, Guaranty Substitution would not occur, and OCC would continue to be responsible for effecting the settlement of such Defaulted NSCC Member Transactions pursuant to OCC’s By-Laws and Rules (unless both clearing agencies agree otherwise).

Finally, the New Accord also would provide for the consistent treatment of all exercise and assignment activity under the agreement. Under the Existing Accord, “standard”<sup>19</sup> option contracts become guaranteed by NSCC when the Common Member meets its morning Clearing Fund Required Deposit at NSCC while “non-standard” exercise and assignment activity becomes guaranteed by NSCC at midnight of the day after trade date (T+1). Under the New Accord, all exercise and assignment activity for Eligible Securities would be guaranteed by NSCC as of the Guaranty Substitution Time, under the circumstances described above, further simplifying the framework for the settlement of such contracts.

*Other Terms of the New Accord*

The New Accord also would include a number of other provisions intended to either generally maintain certain terms of the Existing Accord or improve the procedures, information sharing, and overall governance process under the new agreement. Many of these terms are additions to or improvements upon the terms of the Existing Accord.

Under the proposed New Accord, OCC and NSCC would agree to address the specifics regarding the time, form and manner of various required notifications and actions in a separate service level agreement which the parties would be able to revisit as their operational needs evolve. The service level agreement would also specify an effective date for the New Accord, which, as mentioned above, would occur on a date following approval and effectiveness of all required regulatory submissions to be filed by

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<sup>19</sup> Option contracts with “standard” expirations expire on the third Friday of the specified expiration month, while “non-standard” contracts expire on other days of the expiration month.

OCC and NSCC with the appropriate regulatory authorities. Similar to the Existing Accord, the proposed New Accord would remain in effect (a) until it is terminated by the mutual written agreement of OCC and NSCC, (b) until it is unilaterally terminated by either clearing agency upon one year's written notice (as opposed to six months under the Existing Accord), or (c) until it is terminated by either NSCC or OCC upon the bankruptcy or insolvency of the other, provided that the election to terminate is communicated to the other party within three business days by written notice.

Under the proposed New Accord, NSCC would agree to notify OCC if NSCC ceases to act for a Common Member pursuant to the NSCC Rules no later than the earlier of NSCC's provision of notice of such action to the governmental authorities or notice to other NSCC Members. Furthermore, if an NSCC Member for which NSCC has not yet ceased to act fails to satisfy its Clearing Fund obligations to NSCC, NSCC would be required to notify OCC promptly after discovery of the failure. Likewise, OCC would be required to notify NSCC of the suspension of a Common Member no later than the earlier of OCC's provision of notice to the governmental authorities or other OCC Clearing Members.

Under the Existing Accord, NSCC and OCC agree to share certain reports and information regarding settlement activity and obligations under the agreement. The New Accord would enhance this information sharing between the clearing agencies. Specifically, NSCC and OCC would agree to share certain information, including general risk management due diligence regarding Common Members, lists of Common Members, and information regarding the amounts of Common Members' margin and settlement obligations at OCC or Clearing Fund Required Deposits at NSCC. NSCC and OCC

would also be required to provide the other clearing agency with any other information that the other reasonably requests in connection with the performance of its obligations under the New Accord. All such information would be required to be kept confidential, using the same care and discretion that each clearing agency uses for the safekeeping of its own members' confidential information. NSCC and OCC would each be required to act in good faith to resolve and notify the other of any errors, discrepancies or delays in the information it provides.

The New Accord also would include new terms to provide that, to the extent one party is unable to perform any obligation as a result of the failure of the other party to perform its responsibilities on a timely basis, the time for the non-failing party's performance would be extended, its performance would be reduced to the extent of any such impairment, and it would not be liable for any failure to perform its obligations. Further, NSCC and OCC would agree that neither party would be liable to the other party in connection with its performance of its obligations under the proposed New Accord to the extent it has acted, or omitted or ceased to act, with the permission or at the direction of a governmental authority. Moreover, the proposed New Accord would provide that in no case would either clearing agency be liable to the other for punitive, incidental or consequential damages. The purpose of these new provisions is to provide clear and specific terms regarding each clearing agency's liability for non-performance under the agreement.

The proposed New Accord would also contain the usual and customary representations and warranties for an agreement of this type, including representations as to the parties' good standing, corporate power and authority and operational capability,

that the agreement complies with laws and all government documents and does not violate any agreements, and that all of the required regulatory notifications and filings would be obtained prior to the New Accord's effective date. It would also include representations that the proposed New Accord constitutes a legal, valid and binding obligation on each of OCC and NSCC and is enforceable against each, subject to standard exceptions. Furthermore, the proposed New Accord would contain a force majeure provision, under which NSCC and OCC would agree to notify the other no later than two hours upon learning that a force majeure event has occurred and both parties would be required to cooperate in good faith to mitigate the effects of any resulting inability to perform or delay in performing.

#### **Proposed Amendments to OCC's By-Laws and Rules**

Given the key differences between the Existing Accord and the New Accord, as described above, OCC proposes certain changes to its By-Laws and Rules in order to accommodate the terms of the New Accord. The primary purpose of the proposed changes is to: (1) reflect the expanded scope of the New Accord, (2) reflect changes related to the new Guaranty Substitution mechanics of the New Accord; and (3) make other changes necessary to conform to the terms of the New Accord or to otherwise provide additional clarity around the settlement and margining<sup>20</sup> treatment of: (i) Eligible Securities under the New Accord, (ii) non-regular way securities settling through the

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<sup>20</sup> OCC notes that, while it is proposing changes to its Rules concerning margin requirements (e.g., which transactions would be included as part of OCC's margin calculation at a given point in time), OCC is not proposing any changes to its margin model (with the exception that OCC would no longer collect and hold margin for positions after NSCCs Guaranty has taken effect under the New Accord).



facilities of NSCC but outside of the New Accord, and (iii) those securities settling outside of the New Accord and away from NSCC on a broker-to-broker basis. These proposed changes are discussed in greater detail below.

*Changes Related to the Expanded Scope of the New Accord*

First, OCC proposes to amend and replace the defined term “CNS-eligible”<sup>21</sup> in order to reflect the expanded definition of Eligible Securities under the New Accord. The term “CNS-eligible” currently describes the securities underlying the physically-settled stock options that are eligible under the Existing Accord to be settled through NSCC’s CNS Accounting Operation. Under the New Accord, however, the term Eligible Securities is more broadly defined to include securities (both Stock Options and Stock Futures) eligible for settlement via NSCC’s CNS Accounting Operation and NSCC’s Balance Order Accounting Operation. Accordingly, OCC proposes to use “CCC,” for “correspondent clearing corporation”<sup>22</sup> to describe the Eligible Securities. Thus, the term “CCC-eligible” would replace “CNS-eligible” throughout OCC’s By-Laws and Rules.

Next, because the New Accord would include the settlement of Stock Futures, OCC proposes to make several changes to its rules regarding Stock Futures to accommodate this expansion. More specifically, OCC proposes a conforming amendment to Rule 901 Interpretation and Policy (.02) to clarify that, under the New Accord, OCC will, subject to its discretion, cause the settlement of all matured Stock

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<sup>21</sup> See Article I, Section (C)(23) of OCC’s By-Laws.

<sup>22</sup> Under Article I of OCC’s By-Laws, the term "correspondent clearing corporation" means the National Securities Clearing Corporation or any successor thereto which, by agreement with the Corporation, provides facilities for settlements in respect of exercised option contracts or BOUNDS or in respect of delivery obligations arising from physically-settled stock futures.

Futures to be made through the facilities of NSCC to the extent that the underlying securities are CCC-eligible as the term is currently proposed.

OCC also proposes clarifying and conforming revisions to newly renumbered Rule 901(e) (currently Rule 901(d)) to specify that settlements made through the facilities of the correspondent clearing corporation are governed by Rule 901 and to clarify that, under the New Accord, specifications made in any Delivery Advice may be revoked up until the point at which NSCC's Guaranty has taken effect (the "obligation time" as discussed below) and not the opening of business on the delivery date.

*Changes Related to Guaranty Substitution*

OCC also proposes a series of amendments to its Rules to accurately reflect the process under which the Guaranty Substitution occurs under the New Accord. First, OCC proposes to amend Rule 901(c) so that the term "obligation time" -- the time that the correspondent clearing corporation becomes unconditionally obligated, in accordance with its rules, to effect settlement in respect thereof or to close out the securities contract arising therefrom -- is synonymous with the Guaranty Substitution Time under the New Accord and (i.e., (i) settlement obligations are reported to and are not rejected by NSCC; (ii) NSCC has not notified OCC that it has ceased to act for the relevant Clearing Member; and (iii) the Clearing Fund requirements of the relevant Clearing Member are received by NSCC). Under the New Accord, if a default occurs prior to the Guaranty Substitution Time, the Guaranty Substitution will not occur for any E&A/Delivery Transactions involving the Defaulting NSCC Member, and OCC will continue to guarantee settlement for those Defaulted NSCC Member Transactions.

Next, OCC proposes to amend language in newly renumbered Rule 901(i) (currently Rule 901(h)) regarding the timing of the end of a Clearing Member's obligations to OCC with respect to securities to be settled through NSCC. Under the Existing Accord and OCC's existing Rules, a Clearing Member's obligations to OCC end only once settlement is completed. Under the New Accord, however, a Clearing Member's obligations to OCC will end when OCC's obligations with respect to guaranteeing settlement of the security would end (*i.e.*, the Guaranty Substitution Time or "obligation time"). OCC therefore proposes to amend newly renumbered Rule 901(i) to specify that a Clearing Member's obligations to OCC will be deemed completed and performed once the "obligation time" has occurred.

As discussed above, the New Accord eliminates the provisions of the Existing Accord whereby OCC and NSCC guaranteed each other the performance of Common Members and made certain payments to the other upon the default of a Common Member. As such, OCC proposes to delete discussions of such guarantees and payments from newly renumbered Rule 901(i) and Rule 1107.

OCC also proposes amendments to Rules 910 and 911, which set forth procedures for handling failures to make or take delivery of securities in settlement of exercised or assigned Stock Options and matured physically-settled Stock Futures, to add language to both rules to clarify that the failure procedures set forth therein would not apply with respect to any delivery to be made through NSCC pursuant to Rule 901. Under the New Accord, once the Guaranty Substitution Time with respect to a specific E&A/Delivery Transaction occurs, OCC's Guaranty ends and NSCC's Guaranty begins, leaving OCC with no involvement with or responsibility for the settlement of the securities underlying

that transaction. Therefore, if there is a failure to make or take delivery with respect to that transaction after Guaranty Substitution has occurred, the NSCC Rules will govern that failure. With respect to deliveries made on a broker-to-broker basis under OCC Rules 903 through 912 (including those that may utilize NSCC's Obligation Warehouse services), and which are not governed by Rule 901, Guaranty Substitution does not occur and OCC's failure procedures would apply.

*Changes to OCC's Margin Rules*

Under the New Accord, OCC will no longer collect margin on a transaction once it is no longer guaranteeing settlement for that transaction. As such, OCC proposes to add language to Rule 601(f) to clarify that OCC's margin calculations will not include delivery obligations arising from any Stock Options or Stock Futures that are eligible for settlement through NSCC and for which OCC has no further settlement obligations because either (i) Guaranty Substitution has occurred for E&A/Delivery Transactions under the New Accord (as described in revised Rule 901(c)) or (ii) NSCC has otherwise accepted transactions for non-regular way settlement under the NSCC Rules (as describe in newly proposed Rule 901(d)).<sup>23</sup> By not including these transactions as part of OCC's margin calculation, OCC is hoping to alleviate instances of "double-margining" for Common Members that may otherwise simultaneously owe margin to NSCC and OCC with respect to the same position.

OCC also proposes to delete Rule 608A in its entirety. The New Accord seeks to eliminate the situation under the Existing Accord where Common Members are

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<sup>23</sup> Related revisions to Rule 901(c) and newly proposed Rule 901(d) are discussed in more detail below.

effectively “double-margined” or required to simultaneously post margin with OCC and NSCC with respect to the same position. As the New Accord eliminates this double-margining scenario, Rule 608A, which provides procedures pursuant to which a Clearing Member could use the securities deposited as margin with OCC as collateral to secure a loan to pay its margin obligations to NSCC, is now unnecessary.

*Other Clarifying Changes Not Related to the New Accord*

OCC also proposes to amend its Rules to make clarifying changes that are not directly required by the New Accord but would provide additional clarity in its Rules in light of other changes being made to accommodate the New Accord. Specifically, OCC proposes to revise Rule 901 Interpretation and Policy (.02) to provide that transactions that involve the delivery of non-CCC eligible securities made on a broker-to-broker basis (and away from NSCC) may nevertheless involve the use of certain services of NSCC (e.g., NSCC’s Obligation Warehouse). For such transactions, because they are not covered by the New Accord and NSCC at no point guarantees settlement, OCC Rule 901 would not apply and delivery is governed by the broker-to-broker settlement procedures set forth in OCC Rules 903 through 912, as is the case currently today. Additionally, while OCC’s existing Rules do not prohibit broker-to-broker settlements from being facilitated through the services of a correspondent clearing corporation, they do not explicitly contemplate the possibility. OCC also proposes to make clarifying amendments to Rule 904(b) and 910A(a) to more clearly distinguish between settlements effected through NSCC’s CNS Accounting Operation or Balance Order Accounting Operations in accordance with OCC Rule 901 and deliveries effected on a broker-to-

broker basis utilizing services of NSCC under OCC Rules 903 through 912 and to clearly state which OCC Rules apply in each context.

Further, OCC proposes to add a new paragraph (d) to Rule 901 to clarify that OCC still intends, at its discretion, to effect settlement of Stock Options and Stock Futures that are scheduled to be settled on the first business day after exercise or maturity through NSCC pursuant to Rule 901 and the relevant provisions of the NSCC Rules, even though such contracts are outside the scope of the New Accord. These contracts would continue to be settled as they are currently today.

OCC also proposes clarifying and conforming changes to the introductory language of Chapter IX of the Rules. Specifically, OCC proposes conforming changes to the Rule to reflect the replacement of the defined term “CNS-eligible” with “CCC-eligible” as described above. The proposed changes would also clarify that OCC’s broker-to-broker settlement rules are contained in Rules 903-912, as Rule 902 concerns Delivery Advices, which also may be applicable to settlements made through the correspondent clearing corporation pursuant to Rule 901. In addition, the proposed changes to the introductory language of Chapter IX of the Rules would provide additional clarity around OCC’s existing authority to alter a previous designation of a settlement method at any time prior to the designated delivery date by specifying that this authority would apply to both settlements to be made through the facilities of the correspondent clearing corporation pursuant to Rule 901 or settlements to be made on a broker-to-broker basis pursuant to Rules 903 through 912. Finally, OCC proposes a number of conforming changes to Rules 901 and 912 to reflect the renumbering of various Rule provisions due to the proposed amendments described above.

## 2. Statutory Basis

Section 17A(b)(3)(F) of the Act requires, in part, that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions, to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible, and to foster cooperation and coordination with persons engaged in the clearance and settlement of securities transactions.<sup>24</sup> OCC believes that the proposed rule change is consistent with the requirements of Section 17A(b)(3)(F) of the Act<sup>25</sup> and the rules thereunder applicable to OCC for the reasons set forth below.

In connection with the proposal to enhance the timing of the Guaranty Substitution, the proposed New Accord, and related changes to OCC's By-Laws and Rules, would establish clear, transparent, and enforceable terms for the settlement of OCC's cleared Stock Options and Stock Futures through the facilities of NSCC. Specifically, the New Accord would continue to provide a sound framework for the settlement of certain Stock Options issued and cleared by OCC through the facilities of NSCC and would extend this framework to a clearly defined scope of additional Stock Options and Stock Futures transactions. In addition, the proposed rule change would simplify the settlement process for those Stock Options currently settled under the Existing Accord by clarifying the timing and mechanisms by which OCC's guaranty ends and NSCC's guaranty begins by focusing on the timing of the Guaranty Substitution, as described in detail above. By clarifying and simplifying the settlement process for these

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<sup>24</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>25</sup> Id.

transactions, the New Accord would operate to minimize the risk of interruptions to clearing agency operations in the event of a Common Member default, and, in this way, would promote the prompt and accurate clearance and settlement of securities transactions.

In addition, by eliminating any ambiguity regarding which clearing agency is responsible for guaranteeing settlement at any given moment, the proposal to enhance the timing of the Guaranty Substitution would provide greater certainty that in the event of a Common Member default, the default would be handled pursuant to the rules and procedures of the clearing agency whose guarantee is then in effect and the system for the clearance and settlement of Stock Options and Stock Futures would continue with minimal interruption. This greater certainty would strengthen OCC's and NSCC's ability to plan for and manage, and therefore would mitigate, the risk presented by Common Member defaults. It would also minimize the "double margining" issue that occurs under the Existing Accord so that Common Members would no longer be required to post margin at both clearing agencies to cover the same E&A/Delivery Transactions, thereby reducing their potential exposures across multiple clearing agencies for the same positions. In this way, the New Accord is designed to safeguard the securities and funds which are in the custody or control of OCC or for which it is responsible.

The proposals to expand the category of securities eligible for settlement and guarantee and to apply uniform treatment to standard and non-standard options under the New Accord would provide consistent treatment across all expiries for products with regular way settlement cycle specifications, and would promote the prompt and accurate clearance and settlement of these additional securities transactions.



In connection with the proposal to enhance the information sharing arrangement between NSCC and OCC, NSCC and OCC would agree to share certain information, including general risk management due diligence regarding Common Members, lists of Common Members, and information regarding the amounts of Common Members' margin and settlement obligations at OCC or Clearing Fund Required Deposits at NSCC. In this way, the New Accord would foster cooperation and coordination between OCC and NSCC in the settlement of securities transactions.

Finally, other proposed changes to OCC's Rules would provide additional clarity, transparency, and certainty around the settlement and margining treatment of various securities transactions cleared by OCC (including those settled under the New Accord, those otherwise settled through the facilities of NSCC, and those that settle on a broker-to-broker basis away from NSCC). By providing its Clearing Members with this additional clarity, transparency, and certainty in OCC's Rules, the proposed rule change would promote the prompt and accurate clearance and settlement of securities transactions and the safeguarding of securities and funds which are in the custody or control of OCC or for which it is responsible

Therefore, for the reasons stated above, OCC believes that the proposed rule change is consistent with the requirements of Section 17A(b)(3)(F) of the Act.<sup>26</sup>

Rule 17Ad-22(e)(1) under the Act requires that a covered clearing agency establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for a well-founded, clear, transparent, and enforceable legal basis for

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<sup>26</sup>

Id.

each aspect of its activities in all relevant jurisdictions.<sup>27</sup> The New Accord would constitute a legal, valid and binding obligation on each of OCC and NSCC, which is enforceable against each clearing agency. In connection with the proposal to enhance the timing of the Guaranty Substitution, the New Accord would establish clear, transparent, and enforceable terms for the settlement of OCC's cleared Stock Options and Stock Futures through the facilities of NSCC and would simplify the settlement process for those Stock Options currently settled under the Existing Accord. By clarifying the timing and mechanisms by which OCC's Guaranty ends and NSCC's Guaranty begins by focusing on the timing of the Guaranty Substitution, the new Accord, specifically the proposal to enhance the timing of the Guaranty Substitution, would provide a clear, transparent and enforceable legal basis for OCC's and NSCC's obligations during the event of a Common Member default. As a result, OCC believes that the proposal is consistent with the requirements of Rule 17Ad-22(e)(1).<sup>28</sup>

Rule 17Ad-22(e)(20) under the Act requires, in part, that a covered clearing agency establish, implement, maintain and enforce written policies and procedures reasonably designed to identify, monitor, and manage risks related to any link the covered clearing agency establishes with one or more other clearing agencies or financial market utilities.<sup>29</sup>

OCC is proposing to adopt the New Accord in order to address the risks it has identified related to its existing link with the NSCC within the Existing Accord.

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<sup>27</sup> 17 CFR 240.17Ad-22(e)(1).

<sup>28</sup> Id.

<sup>29</sup> 17 CFR 240.17Ad-22(e)(20).

Specifically, under the terms of the Existing Accord, even after NSCC's guarantee has come into effect, OCC is not released from its guarantee with respect to the Options E&A until certain deadlines have passed on the first business day following the scheduled settlement date without NSCC notifying OCC that the relevant Common Member has failed to meet an obligation to NSCC and/or NSCC has ceased to act for such firm. This current process results in a period of time where NSCC's trade guarantee and OCC's guarantee both apply to the same positions, and, therefore, both clearing agencies are holding margin against the same Options E&A position. As a result, the Existing Accord provides for a more complicated framework for the settlement of certain Stock Options. These complications could give rise to inconsistencies with regard to the development and application of interdependent policies and procedures between OCC and NSCC, which could lead to unanticipated disruptions in OCC's or NSCC's clearing operations.

In connection with the proposal to enhance the timing of the Guaranty Substitution, the New Accord would provide for a clearer, simpler framework for the settlement of certain Stock Options and Stock Futures by pinpointing a specific moment in time, the Guaranty Substitution Time, at which guarantee obligations would transfer from OCC to NSCC. The New Accord would eliminate any ambiguity regarding which clearing agency is responsible for guaranteeing settlement at any given moment. Establishing a precise Guaranty Substitution Time would also provide greater certainty that in the event of a Common Member default, the default would be handled pursuant to the rules and procedures of the clearing agency whose guarantee is then in effect and the system for the clearance and settlement of Stock Options and Stock Futures would continue with minimal interruption. This greater certainty would strengthen OCC's and

NSCC's ability to plan for and manage, and therefore would mitigate, the risk presented by Common Member defaults to OCC and NSCC, other members, and the markets the clearing agencies serve. Therefore, through the adoption of the proposal to enhance the timing of the Guaranty Substitution, OCC would more effectively manage its risks related to the operation of the New Accord.

Moreover, in connection with the proposal to put additional arrangements into place concerning the procedures, information sharing, and overall governance processes under the New Accord, NSCC and OCC would agree to share certain information, including general surveillance information regarding their members, so that each clearing agency would be able to effectively identify, monitor, and manage risks that may be presented by certain Common Members. Accordingly, OCC believes the proposed changes are reasonably designed to identify, monitor, and manage risks related to the link established between OCC and NSCC for the settlement of certain Stock Options and Stock Futures in a manner consistent with Rule 17Ad-22(e)(20).<sup>30</sup>

Finally, Rule 17Ad-22(e)(21) under the Act requires that a covered clearing agency establish, implement, maintain and enforce written policies and procedures reasonably designed to, among other things, be efficient and effective in meeting the requirements of its participants and the markets it serves.<sup>31</sup> As noted above, under the Existing Accord, even after NSCC's guarantee has come into effect, OCC is not released from its guarantee with respect to the Options E&A until certain deadlines have passed on the first business day following the scheduled settlement date without NSCC notifying

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<sup>30</sup> Id.

<sup>31</sup> 17 CFR 240.17Ad-22(e)(21).

OCC that the relevant Common Member has failed to meet an obligation to NSCC and/or NSCC has ceased to act for such firm. This results in a period of time where NSCC's guarantee overlaps with OCC's guarantee and where both clearing agencies are holding margin against the same Options E&A positions. In connection with the proposal to enhance the timing of the Guaranty Substitution, the New Accord would minimize this "double margining" issue by introducing a new Guaranty Substitution Time, which would normally occur as soon as NSCC has received all Required Deposits to the Clearing Fund from Common Members, which have been calculated taking into account the relevant E&A/Delivery Transactions, rather than require reimbursement payments from one clearing agency to the other. As a result, Common Members would no longer be required to post margin at both clearing agencies to cover the same E&A/Delivery Transactions. OCC believes that, by simplifying the terms of the existing agreement in this way, the New Accord is designed to be efficient and effective in meeting the requirements of OCC's and NSCC's participants and the markets they serve.

Additionally, the proposal to put additional arrangements into place concerning the procedures, information sharing, and overall governance processes under the New Accord would create new efficiencies in the management of this important link between OCC and NSCC. The proposal to enhance information sharing between OCC and NSCC would allow the clearing agencies to more effectively identify, monitor, and manage risks that may be presented by certain Common Members, and would create new efficiencies in their general surveillance efforts with respect to these firms.

In these ways, OCC believes the proposed New Accord is consistent with the requirements of Rule 17Ad-22(e)(21).<sup>32</sup>

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 Act<sup>33</sup> requires that the rules of a clearing agency not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. OCC does not believe the proposed rule change would have any impact or impose any burden on competition. The primary purpose of the proposed rule change is to adopt a clearer, simpler framework for the settlement of Stock Options issued by OCC and settled through the facilities of NSCC through the introduction of a new Guaranty Substitution Time. The proposed New Accord would also extend this framework to both (1) Stock Options contracts in securities that are eligible to be settled through NSCC's Balance Order Accounting Operation and (2) certain delivery obligations arising from matured physically-settled Stock Futures contracts cleared by OCC that are eligible to be settled through NSCC's CNS Accounting Operation or Balance Order Accounting Operation. The New Accord would put additional arrangements into place concerning the procedures, information sharing, and overall governance processes under the agreement. OCC is also proposing to make certain clarifying and conforming changes to the OCC Rules as necessary to implement the New Accord or to otherwise provide more clarity in OCC's Rules. None of these proposed

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<sup>32</sup> Id.

<sup>33</sup> 15 U.S.C. 78q-1(b)(3)(I).

rule changes, either individually or together, would affect Common Members' access to OCC's services, nor would any of these proposed changes disadvantage or favor any particular user in relationship to another user. As such, OCC believes that the proposed changes would not have any impact or impose any burden on competition.

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

Written comments were not and are not intended to be solicited with respect to the proposed rule change and none have been received. OCC will notify the Commission of any written comments received by OCC.

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

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve or disapprove the proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-OCC-2017-013 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-2017-013. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, 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 [http://www.theocc.com/components/docs/legal/rules\\_and\\_bylaws/sr\\_occ\\_17\\_013.pdf](http://www.theocc.com/components/docs/legal/rules_and_bylaws/sr_occ_17_013.pdf).



All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

All submissions should refer to File Number SR-OCC-2017-013 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated Authority.<sup>34</sup>

Robert W. Errett  
Deputy Secretary

Action as set forth recommended herein  
APPROVED pursuant to authority delegated  
by the Commission under Public Law 87-  
592.

For: Division of Trading and Markets

By: \_\_\_\_\_

Print Name: \_\_\_\_\_

Date: \_\_\_\_\_

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<sup>34</sup> 17 CFR 200.30-3(a)(12).

**EXHIBIT 5A**

Underlined text indicates new text

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**THE OPTIONS CLEARING CORPORATION**

**BY-LAWS**

\* \* \*

**ARTICLE I – Definitions**

SECTION 1. Unless the context requires otherwise (or except as otherwise specified in the By-Laws or Rules), the terms defined herein shall, for all purposes of these By-Laws and the Rules of the Corporation, have the meanings herein specified.

A. – B. *No change.*

C.

(1) – (7) *No change.*

**CCC-Eligible**

(8) The term “CCC-eligible,” as used at any point in time with reference to an underlying security shall mean that securities contracts in the underlying security arising from the exercise or maturity of a cleared security are eligible as of that point in time for settlement through the Continuous Net Settlement Accounting Operation or the Balance Order Accounting Operation of the National Securities Clearing Corporation.

(8) – (22) *Renumbered as (9) – (23); otherwise no change*

**~~CNS-Eligible~~**

~~(23) The term “CNS-eligible,” as used at any point in time with reference to an underlying security shall mean that securities contracts in the underlying security arising from the exercise or maturity of a cleared security are eligible as of that point in time for settlement through the Continuous Net Settlement System of National Securities Clearing Corporation.~~

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**EXHIBIT 5B**

Underlined text indicates new text

~~Strikethrough~~ text indicates deleted text

**THE OPTIONS CLEARING CORPORATION****RULES**

\* \* \*

**CHAPTER VI – Margins**

\* \* \*

**Rule 601 – Margin Requirements**

(a) – (e) *No change.*

(f) *Exclusions from Margin Requirement Calculation.* The following shall be excluded from the margin requirement calculation for any account pursuant to Rule 601(c), (d), or (e):

(1) – (3) *No change.*

(4) exercised or assigned option contracts or matured physically-settled stock futures contracts that are CCC-eligible with respect to which the Corporation has no further settlement obligations under Rules 901(c) and 901(d).

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**~~Rule 608A – Withdrawal and Pledge of Securities Deposited as Margin~~**

~~(a) Subject to such procedures and limitations as the Corporation shall specify, the Corporation may allow a Clearing Member to withdraw securities held by the Corporation as margin and to pledge such securities to an approved lender as collateral for a loan to the Clearing Member, the proceeds of which are to be disbursed by the lender directly to the Corporation and applied against the Clearing Member's settlement obligations with the correspondent clearing corporation.~~

~~(b) When securities deposited as margin are withdrawn and pledged pursuant to this Rule, the amount of margin required on the withdrawal date for the account from which the securities are withdrawn shall be reduced by an amount equal to the value then assigned by the Corporation to such securities for margin purposes.~~

~~(c) A Clearing Member's request to withdraw and pledge securities pursuant to this Rule shall~~

~~be deemed to constitute the Clearing Member's certificate and representation to the Corporation that the pledge of such securities will not contravene any provision of law or any rule thereunder.~~

~~...*Interpretations and Policies:*~~

~~.01 Initially, only equity securities meeting the requirements of Rule 604(d) may be withdrawn and pledged pursuant to this Rule. The Corporation intends to permit the withdrawal and pledge of other types of securities as and when the requisite systems and procedures are developed.~~

~~.02 Initially, withdrawals and pledges pursuant to this Rule will be permitted only on settlement dates for exercises of expiring equity options (other than flexibly structured options). The Corporation may in the future permit such withdrawals and pledges on other dates as well.~~

~~.03 Only those Clearing Members that settle their own equity option exercises and assignments through the correspondent clearing corporation will be permitted to withdraw and pledge securities pursuant to this Rule.~~

~~.04 The Corporation will permit the withdrawal and pledge pursuant to this Rule of securities held as margin only to the extent that:~~

~~(1) as of the withdrawal date, the amount of the loan to be collateralized by such securities:~~

~~(a) is not less than the value assigned by the Corporation to such securities for margin purposes; and~~

~~(b) is not greater than the lesser of:~~

~~—— (i) the margin requirement for the account from which the securities are to be withdrawn; and~~

~~—— (ii) the amount of the Corporation's guarantee exposure, as calculated by the Corporation, in respect of the Clearing Member's settlement obligations to the correspondent clearing corporation; and~~

~~(2) payment of the loan proceeds to the correspondent clearing corporation will result in a corresponding reduction in the guarantee exposure referred to in clause (1)(b)(ii).~~

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## CHAPTER IX – Delivery of Underlying Securities and Payment

### Introduction

The Rules in this Chapter are applicable to the discharge of delivery and payment obligations arising out of the exercise of physically settled stock option contracts and the maturity of

physically settled stock futures contracts. As a general policy, the Corporation will direct that such obligations be settled through the facilities of the correspondent clearing corporation as specified in Rule 901 to the extent that the security to be delivered and received is ~~CNS-eligible~~CCC-eligible, and will direct that such obligations be settled on a broker-to-broker basis as specified in Rules ~~902-903~~ through 912 to the extent that the security to be delivered and received is not ~~CNS-eligible~~CCC-eligible. However, the Corporation may in its discretion make exceptions to this policy, either to direct that the delivery of ~~CNS-eligible-CCC-eligible~~ securities be made on a broker-to-broker basis as specified in Rules ~~902-903~~ through 912, utilizing services of the correspondent clearing corporation or otherwise, or (with the agreement of the correspondent clearing corporation) to direct that the delivery of ~~non-CNS-eligible-non-CCC-eligible~~ securities be made through the facilities of the correspondent clearing corporation as specified in Rule 901. The Corporation may alter a previous designation of a settlement method at any time ~~before~~(i) prior to the obligation time (as defined in Rule 901(c)) for any settlement to be made through the facilities of the correspondent clearing corporation pursuant to Rule 901 or (ii) prior to the designated delivery date for any settlement to be made on a broker-to-broker basis pursuant to Rules 903 through 912 by giving the affected Clearing Members such notice thereof as is practicable under the circumstances.

#### **Rule 901 – Settlement Through Correspondent Clearing Corporations**

(a) Every Stock Clearing Member and every Clearing Member that effects transactions in physically-settled stock futures shall be and remain a participant in good standing of the correspondent clearing corporation; provided, however, that the foregoing shall not apply to: (i) an Appointing Clearing Member during a period when such Appointing Clearing Member has in effect an appointment of an Appointed Clearing Member pursuant to subparagraph ~~(fg)~~ hereof; or (ii) a Canadian Clearing Member on behalf of which CDS maintains an identifiable subaccount in a CDS account at the correspondent clearing corporation, provided that CDS is a participant in good standing of the correspondent clearing corporation during the period when such Canadian Clearing Member has in effect an appointment of CDS pursuant to subparagraph ~~(gh)~~ hereof.

(b) *No change.*

(c) Settlement obligations for CCC-eligible securities that settle “regular way,” as defined in the rules and procedures of the correspondent clearing corporation, will ordinarily be directed for settlement through the facilities of the correspondent clearing corporation. Unless otherwise agreed between the correspondent clearing corporation and the Corporation, if (i) such settlement obligations are reported to and are not rejected by the correspondent clearing corporation; (ii) the correspondent clearing corporation has not notified the Corporation that it has ceased to act for the relevant Clearing Member or Appointed Clearing Member; and (iii) the clearing fund requirements of the relevant Clearing Member or Appointed Clearing Member owing to such correspondent clearing corporation, as determined in accordance with its rules and procedures, are received by the correspondent clearing corporation prior to the time when it becomes unconditionally obligated, in accordance with its rules, to effect settlement in respect thereof or to close out the securities contract arising therefrom (the “obligation time”), the Corporation shall have no further obligation in respect of such settlement obligations, other than

such obligations as the Corporation may have pursuant to its agreement with the correspondent clearing corporation, and, ~~except as provided in subparagraph (h) hereof,~~ full settlement shall be deemed to have been made by the Corporation in respect of such settlement obligations, from and after the ~~obligation time~~ when the correspondent clearing corporation becomes unconditionally obligated, in accordance with its rules, to effect settlement in respect thereof or to close out the securities contract arising therefrom (the "obligation time"). If an obligation to make delivery is netted by the Corporation against an obligation to receive in accordance with subparagraph (b) hereof, full settlement shall be deemed to have been made in respect thereof at the opening of business of the Corporation on the delivery date. If the Corporation takes action pursuant to subparagraph (de) hereof, settlement shall be made in accordance with the provisions of subparagraph (de). ~~Except as provided in subparagraph (h) hereof, f~~From and after the time when settlement is deemed to have been made pursuant to the ~~first~~second sentence of this subparagraph (c), the obligations of the Delivering and the Receiving Clearing Member in respect of the contracts deemed to have been settled, and any other obligations resulting from settlement in respect thereof, shall be determined by the rules and procedures of the correspondent clearing corporation.

(d) It will ordinarily be the policy of the Corporation to cause settlement of exercised stock option contracts and matured physically-settled stock futures contracts for CCC-eligible securities that are scheduled to be settled on the first business day after exercise or maturity (i.e., securities that do not settle "regular way" as defined in the rules and procedures of the correspondent clearing corporation) to be made through the facilities of the correspondent clearing corporation in accordance with the rules and procedures of the correspondent clearing corporation. If such settlement obligations are reported to and are not rejected by the correspondent clearing corporation prior to the time when it becomes unconditionally obligated, in accordance with its rules, to effect settlement in respect thereof or to close out the securities contract arising therefrom, the Corporation shall have no further obligation in respect of such settlement obligations. However, the Corporation may in its discretion determine to alter this policy in particular circumstances.

~~(de)~~ A specification in any Delivery Advice that settlement is to be made through the facilities of the correspondent clearing corporation pursuant to this Rule 901 may be revoked by the Corporation at any time prior to the ~~opening of business on the delivery date obligation time~~ by an appropriate notice to the Receiving and Delivering Clearing Members. In the event of such revocation, delivery and payment shall be made in accordance with Rules 903 through 912; provided, however, that the Executive Chairman, Chief Operating Officer or the Chief Administrative Officer of the Corporation may, upon the application of the Receiving or the Delivering Clearing Member, extend or postpone the time for delivery to a date not more than three business days after the date of such revocation.

(e) – (g) *Renumbered as (f) – (h); otherwise no change.*

~~(hi)~~ Notwithstanding any other provision of the By-Laws and Rules, the obligations of a Clearing Member to the Corporation in respect of the settlement of any securities contract arising from an exercised or matured cleared security which is settled by or on behalf of the Clearing Member through the correspondent clearing corporation pursuant to this Rule 901 will ~~not~~ be deemed to

be completed and performed ~~until settlement is completed in respect of such securities contract with the correspondent clearing corporation~~ once the obligation time, as defined in Rule 901(c), in respect of such securities contract has occurred and the Corporation has no further responsibility in respect of such securities contract to the correspondent clearing corporation. ~~The terms of any securities contract arising from an exercised or matured cleared security which is to be settled pursuant to this Rule 901 through the correspondent clearing corporation shall include any guarantee made by the Corporation to the correspondent clearing corporation of the performance by the Clearing Member (or an Appointed Clearing Member or CDS, if any such entity has been appointed by the Clearing Member to act on its behalf) of its obligations to effect settlement with the correspondent clearing corporation, and the obligations of the Clearing Member in connection with the settlement of such securities contract shall include the obligation to reimburse the Corporation for any payments made by the Corporation to the correspondent clearing corporation in respect of such settlement pursuant to such guarantee.~~

*. . . Interpretations and Policies:*

**.01** When the Corporation extends or postpones settlements pursuant to Rule 903 the Corporation may for technical reasons defer reporting affected exercised or matured contracts to the correspondent clearing corporation until a new delivery date is fixed. If an ex-date for a dividend or other distribution on the underlying stock occurs between the date of an exercise of an option or maturity date of a stock future and the date when the Corporation reports the resulting settlement obligations to the correspondent clearing corporation, the Delivering Clearing Member may not be obligated, under the rules of the correspondent clearing corporation, to deliver the distributed property. In order to prevent resulting inequities, the Board of Directors has determined pursuant to Rule 901(~~ef~~) that in such cases Delivering Clearing Members shall be obligated to deliver the distributed cash or other property on the delivery date notwithstanding the absence of an obligation to do so under the rules of the correspondent clearing corporation. In the case of cash distributions, such delivery shall be made by appropriate charges and credits to the settlement accounts of Delivering and Receiving Clearing Members with the Corporation. In the case of non-cash distributions, delivery shall be made in such manner as the Corporation shall direct.

**.02** It will ordinarily be the policy of the Corporation to cause settlement of exercised stock option contracts and matured physically-settled futures contracts to be made through the facilities of the correspondent clearing corporation pursuant to Rule 901 to the extent that the security or securities to be delivered and received in such settlement are ~~CNS-eligible~~ CCC-eligible, and to cause settlement of exercised stock option contracts and matured physically-settled futures contracts to be made pursuant to Rules ~~901-903~~ through 912 to the extent that the security or securities to be delivered and received in such settlement are not ~~CNS-eligible~~ CCC-eligible. However, the Corporation may in its discretion determine to alter this policy in particular circumstances, either to cause delivery of ~~CNS-eligible-CCC-eligible~~ securities to be made pursuant to Rules ~~901-903~~ through 912 or (with the agreement of the correspondent clearing corporation) to cause delivery of ~~non-CNS-eligible-non-CCC-eligible~~ securities to be made through the facilities of the correspondent clearing corporation pursuant to Rule 901. For certain non-CCC eligible securities, delivery made on a broker-to-broker basis pursuant to Rules 903 through 912 may nevertheless involve facilities of a correspondent clearing corporation,

~~provided that Rule 901 will not apply to such delivery unless the Corporation and the correspondent clearing corporation otherwise agree. It will ordinarily be the policy of the Corporation to cause delivery and payment obligations arising from matured, physically settled stock futures to be effected through the correspondent clearing corporation whether or not the security to be delivered is CNS eligible; provided, however, that the Corporation may in its discretion direct that delivery and payment be made pursuant to Rules 901 through 912.~~

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#### **RULE 904. – Method of Delivery and Payment; Stock Transfer Taxes**

(a) [No change]

(b) If the Corporation directs that a broker-to-broker settlement be made otherwise than as provided in subsection (a), the Delivering Clearing Member and Receiving Clearing Member shall mutually agree upon the location and method for effecting delivery of each underlying security and payment therefor; unless the Corporation directs that a broker-to-broker settlement be made through the facilities of the National Securities Clearing Corporation.

(c) [No change]

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#### **RULE 910. – Failure to Deliver**

~~(a) The failure procedures set forth in paragraphs (b) – (e) of this Rule apply to deliveries of securities that are effected on a broker-to-broker basis pursuant to Rules 903-912, and such procedures shall not apply to any delivery to be made through the correspondent clearing corporation pursuant to Rule 901. A delivery to be made through the correspondent clearing corporation pursuant to Rule 901 shall be subject to the failure procedures, if any, provided by the rules and procedures of the correspondent clearing corporation.~~

(a) – (d) *Renumbered as (b) – (e); otherwise no change.*

#### **RULE 910A. – Protect Procedures**

(a) The protect procedures set forth in paragraph (b) of this Rule apply to deliveries of securities that are effected on a broker-to-broker basis pursuant to Rules ~~902~~903 through 912 and such procedures shall not apply to any delivery to be made through the correspondent clearing corporation. A delivery to be made through the correspondent clearing corporation shall be subject to the protect procedures, if any, provided by the rules or procedures of the correspondent clearing corporation.

\* \* \*

#### **RULE 911. – Failure to Receive**



(a) The failure procedures set forth in paragraphs (b) – (c) of this Rule apply to deliveries and the receipt of deliveries of securities that are effected on a broker-to-broker basis pursuant to Rules 903-912, and such procedures shall not apply to any delivery or the receipt of any delivery to be made through the correspondent clearing corporation pursuant to Rule 901. A delivery to be made through the correspondent clearing corporation pursuant to Rule 901 shall be subject to the failure procedures, if any, provided by the rules and procedures of the correspondent clearing corporation.

(a) – (b) *Renumbered as (b) – (c); otherwise no change*

#### **RULE 912. – Delivery After "Ex" Date**

Subject to the provisions of Rule 901(~~ef~~), when an exercise notice is properly tendered to the Corporation pursuant to Rule 801, or when the maturity date of a physically-settled stock future occurs, prior to an “ex” date (as fixed by the primary market for the underlying security) for a distribution that causes an adjustment to be made pursuant to the By-Laws, the Delivering Clearing Member shall make delivery as required by such adjustment unless the parties otherwise agree. When an exercise notice is properly tendered to the Corporation, or when the maturity date of a physically-settled stock future occurs, prior to such an “ex” date for a distribution that does not cause an adjustment to be made pursuant to the By-Laws, and delivery of the underlying security is made too late to enable the Receiving Clearing Member to transfer the security into its name and to receive such distribution, the Delivering Clearing Member shall, at the time of delivery, issue its due bill check to the Receiving Clearing Member for the amount of the distribution, which check shall be payable on the payment date of such distribution.

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#### **CHAPTER XI – SUSPENSION OF A CLEARING MEMBER**

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#### **RULE 1107 – Exercised or Matured Contracts**

(a) Unless the Corporation stipulates otherwise in a particular case, exercised option contracts to which a suspended Clearing Member is party (either as the exercising Clearing Member or as the assigned Clearing Member) and matured, physically-settled futures to which such Clearing Member is a party shall be disposed of as follows:

(1) Exercised option contracts and matured, physically-settled stock futures for which the correspondent clearing corporation is obligated to effect settlement shall be settled in the ordinary course. If the suspended Clearing Member was the assigned Clearing Member in respect of any such exercised option contract, and the exercise notice was allocated by the suspended Clearing Member, or is allocated by the Corporation pursuant to the following provisions of this Rule, to a short position for which a specific deposit or an escrow deposit has been made, then (i) in the case of a call option contract, the Corporation shall obtain delivery of the underlying securities deposited in respect thereof

from the depository and shall promptly liquidate such underlying securities, or (ii) in the case of a put option contract, the Corporation shall make a demand on the depository for payment out of the deposited property of the aggregate exercise price plus all applicable commissions and other charges. ~~The Corporation shall reimburse itself, out of the funds so obtained, for such incremental amount, if any, as the Corporation is obligated to pay to the correspondent clearing corporation under the terms of any applicable exercise settlement agreement by reason of the short positions covered by such specific deposit or escrow deposit. If the aggregate amount of funds so obtained shall exceed the sum of (i) the cost to the Corporation of obtaining such funds (including, in the case of a call, the exercise price paid by the Corporation to the depository against delivery of the underlying securities, or in the case of a put, the cost of the underlying securities delivered by the Corporation to the depository against payment of the exercise price), and (ii) the amount of such reimbursement, if any, the Corporation shall pay over any excess to the suspended Clearing Member or its representative.~~

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