

Required fields are shown with yellow backgrounds and asterisks.

Page 1 of \*       SECURITIES AND EXCHANGE COMMISSION      File No.\* SR -  - \*   
 WASHINGTON, D.C. 20549      Form 19b-4      Amendment No. (req. for Amendments \*)

Filing by National Securities Clearing Corporation  
 Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

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

<b>Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010</b>	<b>Security-Based Swap Submission pursuant to the Securities Exchange Act of 1934</b>
<b>Section 806(e)(1) *</b>	<b>Section 806(e)(2) *</b>
<input type="checkbox"/>	<input type="checkbox"/>
	<b>Section 3C(b)(2) *</b>
	<input type="checkbox"/>

<b>Exhibit 2 Sent As Paper Document</b>	<b>Exhibit 3 Sent As Paper Document</b>
<input type="checkbox"/>	<input type="checkbox"/>

**Description**

Provide a brief description of the action (limit 250 characters, required when Initial is checked \*).

To adopt a new Stock Options and Futures Settlement Agreement with The Options 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 \***

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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 \***

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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 \***

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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**

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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**

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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**

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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**

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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**

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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.

## 1. Text of the Proposed Rule Change

(a) This proposed rule change is filed by National Securities Clearing Corporation (“NSCC”) in connection with proposed changes relating to a new Stock Options and Futures Settlement Agreement (“New Accord”) between NSCC and The Options Clearing Corporation (“OCC,” collectively NSCC and OCC may be referred to herein as the “clearing agencies”), and proposed amendments to Procedures III and XV of the Rules & Procedures of NSCC (“NSCC Rules”) to accommodate the proposed provisions of the New Accord, as described in greater detail below.<sup>1</sup> The proposed changes to Procedures III and XV and the proposed New Accord are attached hereto as Exhibits 5A and 5B, respectively.<sup>2</sup>

(b) Not applicable.

(c) Not applicable.

## 2. Procedures of the Self-Regulatory Organization

The proposed rule change was approved for filing with the Commission by the Risk Committee of NSCC’s Board of Directors at a meeting held on December 20, 2016.

## 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 (such as NSCC) and are not settled through the facilities of OCC. NSCC and OCC are parties to a Third Amended and Restated Options Exercise Settlement Agreement, dated February 16, 1995, as amended (“Existing Accord”),<sup>3</sup> which

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<sup>1</sup> Terms not defined herein are defined in the 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), or in OCC’s By-Laws and Rules, available at <http://optionsclearing.com/about/publications/bylaws.jsp>, as the context implies.

<sup>2</sup> NSCC has also filed an advance notice filing with the Commission in connection with the New Accord. See SR-NSCC-2017-803. OCC also has filed proposed rule change and advance notice filings with the Commission in connection with the New Accord. See OCC filings SR-OCC-2017-013 and SR-OCC-2017-804, respectively.

<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

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>

NSCC proposes to adopt a New Accord with OCC, 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 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, NSCC proposes to make certain clarifying and conforming changes to the NSCC 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

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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>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.”

<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

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**

### *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 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

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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 2.

<sup>7</sup> Supra note 1.

<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. However, in theory, an Options E&A could, due to an error or delay, be reported later than the date of the option's exercise or expiration.

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.

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

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<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.

<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 1.

<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 1.

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

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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.

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 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

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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 1.

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



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>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

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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 1.

#### 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 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.

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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.

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 NSCC Procedures III and XV of the NSCC Rules**

Given the key differences between the Existing Accord and the New Accord, as described above, NSCC proposes certain changes to Procedures III and XV of the NSCC Rules in order to accommodate the terms of the New Accord. In particular, NSCC would update Section B of Procedure III to define the scope of the New Accord. First, the proposed Section B of Procedure III would identify the E&A/Delivery Transactions, and would make clear that the New Accord would apply only to E&A/Delivery Transactions that are in either CNS Securities or Balance Order Securities, as such terms are defined in the NSCC Rules. The proposed Section B of Procedure III would also define the Common Members, or firms that must be named as counterparties to E&A/Delivery Transactions, as “Participating Members.” The proposal would describe the Guaranty Substitution Time and would describe the circumstances under which the Guaranty Substitution would not occur. Finally, the proposed Section B of Procedure III would describe how E&A/Delivery Transactions for which the Guaranty Substitution has occurred would be processed at NSCC both if they are covered by the proposed New Accord and if they are not covered by the proposed New Accord because, for example, they are not transactions in CNS Securities or Balance Order Securities or were not submitted for regular way settlement.

Finally, NSCC is also proposing to amend Procedure XV to remove reference to the exclusion of E&A/Delivery Transactions from the calculation of the mark-to-market margin component of its Clearing Fund calculations, which is no longer applicable under the proposed New Accord where the Guaranty Substitution would replace the transfer of a defaulting Common Member’s margin payments under the Existing Accord. As such, NSCC is not proposing any change to its margining methodology, but will include E&A/Delivery Transactions in the calculation the mark-to-market margin component of Common Members’ Clearing Fund Required Deposits following implementation of the New Accord.

#### **(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>18</sup> NSCC believes that the proposed rule change is consistent with the requirements of Section 17A(b)(3)(F) of the Act<sup>19</sup> and the rules thereunder applicable to NSCC for the reasons set forth below.

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<sup>18</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>19</sup> Id.

In connection with the proposal to enhance the timing of the Guaranty Substitution, the proposed New Accord, and related changes to the NSCC 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 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 NSCC 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, the proposed changes to the NSCC Rules would provide additional clarity, transparency, and certainty around the application of the New Accord to the applicable E&A/Delivery Transactions. By providing its Members with this additional clarity, transparency, and certainty in the NSCC 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 NSCC or for which it is responsible.

Therefore, for the reasons stated above, NSCC believes that the proposed rule change is consistent with the requirements of Section 17A(b)(3)(F) of the Act.<sup>20</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>21</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, NSCC believes that the proposal is consistent with the requirements of Rule 17Ad-22(e)(1).<sup>22</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>23</sup>

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

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<sup>20</sup> Id.

<sup>21</sup> 17 CFR 240.17Ad-22(e)(1).

<sup>22</sup> Id.

<sup>23</sup> 17 CFR 240.17Ad-22(e)(20).

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, NSCC 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, NSCC 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>24</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>25</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

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<sup>24</sup> Id.

<sup>25</sup> 17 CFR 240.17Ad-22(e)(21).

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. NSCC 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, NSCC believes the proposed New Accord is consistent with the requirements of Rule 17Ad-22(e)(21).<sup>26</sup>

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

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

Section 17A(b)(3)(I) of the Act 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.<sup>27</sup> NSCC 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. NSCC is also proposing to make certain clarifying and conforming changes to the NSCC Rules as necessary to implement the New Accord. None of these proposed rule changes, either individually or together, would affect Common Members' access to NSCC's services, nor would any of these proposed changes disadvantage or favor any particular user in relationship to another user. As such, NSCC believes that the proposed changes would not have any impact or impose any burden on competition.

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<sup>26</sup> Id.

<sup>27</sup> 15 U.S.C. 78q-1(b)(3)(I).



**5. Self-Regulatory Organization's Statement on Comments on the Advance Notice 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. NSCC will notify the Commission of any written comments received by NSCC.

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

Not applicable.

**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.

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

Not applicable.

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

Not applicable.

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

Not applicable.

**11. Exhibits**

Exhibit 1 – Not applicable.

Exhibit 1A – Completed notice of proposed rule change for publication in the Federal Register.

Exhibit 2 – Not applicable.

Exhibit 3 – Not applicable.

Exhibit 4 – Not applicable.

Exhibit 5A – Proposed changes to the NSCC Rules.

Exhibit 5B – Stock Options and Futures Settlement Agreement. **[Redacted]**  
**Confidential treatment is requested for Exhibit 5B pursuant to Rule 24b-2 under the Act.**<sup>28</sup>

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17 CFR 240.24b-2.

**EXHIBIT 1A**

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-[\_\_\_\_\_]; File No. SR-NSCC-2017-007)

[DATE]

Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing of Proposed Rule Change to Adopt a New Stock Options and Futures Settlement Agreement with The Options 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, National Securities Clearing Corporation (“NSCC”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II and III below, which Items have been prepared by the clearing agency.<sup>3</sup> 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

The proposed rule change has been filed by NSCC in connection with proposed changes relating to a new Stock Options and Futures Settlement Agreement (“New

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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> On June 1, 2017, NSCC filed this proposed rule change as an advance notice (SR-NSCC-2017-803) with the Commission pursuant to Section 806(e)(1) of the Dodd-Frank Wall Street Reform and Consumer Protection Act entitled the Payment, Clearing, and Settlement Supervision Act of 2010, 12 U.S.C. 5465(e)(1), and Rule 19b-4(n)(1)(i) of the Act, 17 CFR 240.19b-4(n)(1)(i). A copy of the advance notice is available at <http://www.dtcc.com/legal/sec-rule-filings.aspx>. The Options Clearing Corporation also has filed proposed rule change and advance notice filings with the Commission in connection with this proposal. See OCC filings SR-OCC-2017-013 and SR-OCC-2017-804.

Accord”) between NSCC and The Options Clearing Corporation (“OCC,” collectively NSCC and OCC may be referred to herein as the “clearing agencies”), and proposed amendments to Procedures III and XV of the Rules & Procedures of NSCC (“NSCC Rules”) to accommodate the proposed provisions of the New Accord, as described in greater detail below.<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, the clearing agency 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. The clearing agency has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such 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 (such as NSCC) and are not

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<sup>4</sup> Terms not defined herein are defined in the 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), or in OCC’s By-Laws and Rules, available at <http://optionsclearing.com/about/publications/bylaws.jsp>, as the context implies.

settled through the facilities of OCC. NSCC and OCC 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>

NSCC proposes to adopt a New Accord with OCC, 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”).

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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.”

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 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, NSCC proposes to make certain clarifying and conforming changes to the NSCC 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

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 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

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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>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 3.

proposed rule change, such securities are referred to as “CNS Eligible Securities”).<sup>9</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>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

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<sup>9</sup> Supra note 4.

<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. However, in theory, 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.



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.

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

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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 4.

<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 4.

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.

### *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<sup>15</sup>) 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

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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.

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>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>

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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 4.

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

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 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

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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 4.

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>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

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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.



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 NSCC Procedures III and XV of the NSCC Rules**

Given the key differences between the Existing Accord and the New Accord, as described above, NSCC proposes certain changes to Procedures III and XV of the NSCC Rules in order to accommodate the terms of the New Accord. In particular, NSCC would update Section B of Procedure III to define the scope of the New Accord. First, the proposed Section B of Procedure III would identify the E&A/Delivery Transactions, and would make clear that the New Accord would apply only to E&A/Delivery Transactions that are in either CNS Securities or Balance Order Securities, as such terms are defined in the NSCC Rules. The proposed Section B of Procedure III would also define the Common Members, or firms that must be named as counterparties to E&A/Delivery Transactions, as "Participating Members." The proposal would describe the Guaranty Substitution Time and would describe the circumstances under which the Guaranty

Substitution would not occur. Finally, the proposed Section B of Procedure III would describe how E&A/Delivery Transactions for which the Guaranty Substitution has occurred would be processed at NSCC both if they are covered by the proposed New Accord and if they are not covered by the proposed New Accord because, for example, they are not transactions in CNS Securities or Balance Order Securities or were not submitted for regular way settlement.

Finally, NSCC is also proposing to amend Procedure XV to remove reference to the exclusion of E&A/Delivery Transactions from the calculation of the mark-to-market margin component of its Clearing Fund calculations, which is no longer applicable under the proposed New Accord where the Guaranty Substitution would replace the transfer of a defaulting Common Member's margin payments under the Existing Accord. As such, NSCC is not proposing any change to its margining methodology, but will include E&A/Delivery Transactions in the calculation the mark-to-market margin component of Common Members' Clearing Fund Required Deposits following implementation of the New Accord.

## 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>20</sup> NSCC believes that the proposed rule change is consistent with

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<sup>20</sup> 15 U.S.C. 78q-1(b)(3)(F).

the requirements of Section 17A(b)(3)(F) of the Act<sup>21</sup> and the rules thereunder applicable to NSCC 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 the NSCC 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 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

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<sup>21</sup>

Id.

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 NSCC 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, the proposed changes to the NSCC Rules would provide additional clarity, transparency, and certainty around the application of the New Accord to the

applicable E&A/Delivery Transactions. By providing its Members with this additional clarity, transparency, and certainty in the NSCC 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 NSCC or for which it is responsible.

Therefore, for the reasons stated above, NSCC believes that the proposed rule change is consistent with the requirements of Section 17A(b)(3)(F) of the Act.<sup>22</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>23</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

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<sup>22</sup> Id.

<sup>23</sup> 17 CFR 240.17Ad-22(e)(1).

event of a Common Member default. As a result, NSCC believes that the proposal is consistent with the requirements of Rule 17Ad-22(e)(1).<sup>24</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>25</sup>

NSCC is proposing to adopt the New Accord in order to address the risks it has identified related to its existing link with OCC 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>24</sup> Id.

<sup>25</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, NSCC 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, NSCC 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>26</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>27</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 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. NSCC believes that, by simplifying the terms of the existing agreement in

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<sup>26</sup> Id.

<sup>27</sup> 17 CFR 240.17Ad-22(e)(21).

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, NSCC believes the proposed New Accord is consistent with the requirements of Rule 17Ad-22(e)(21).<sup>28</sup>

The proposed rule change is not inconsistent with the existing NSCC Rules, 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 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.<sup>29</sup> NSCC 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

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<sup>28</sup> Id.

<sup>29</sup> 15 U.S.C. 78q-1(b)(3)(I).

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. NSCC is also proposing to make certain clarifying and conforming changes to the NSCC Rules as necessary to implement the New Accord. None of these proposed rule changes, either individually or together, would affect Common Members' access to NSCC's services, nor would any of these proposed changes disadvantage or favor any particular user in relationship to another user. As such, NSCC 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. NSCC will notify the Commission of any written comments received by NSCC.

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 such proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change

should be disapproved.

The proposal shall not take effect until all regulatory actions required with respect to the proposal are completed.

#### 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-NSCC-2017-007 on the subject line.

##### Paper Comments:

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

All submissions should refer to File Number SR-NSCC-2017-007. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed

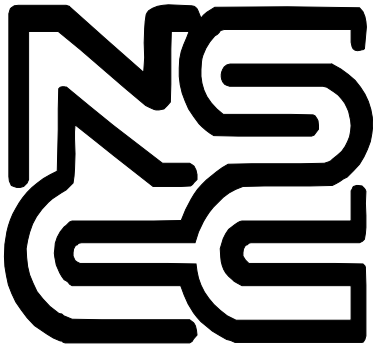
with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's 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 the filing also will be available for inspection and copying at the principal office of NSCC and on DTCC's website (<http://dtcc.com/legal/sec-rule-filings.aspx>). 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-NSCC-2017-007 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>30</sup>

Secretary

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<sup>30</sup> 17 CFR 200.30-3(a)(12).



NATIONAL  
SECURITIES  
CLEARING  
CORPORATION

RULES & PROCEDURES

TEXT OF PROPOSED RULE CHANGE

**Bold and underlined** text indicates proposed added language

**~~Bold and strikethrough~~** text indicates proposed deleted language

PROCEDURE III. TRADE RECORDING SERVICE (INTERFACE WITH QUALIFIED CLEARING AGENCIES)

A. Introduction

Through arrangements with Qualified Clearing Agencies, the Corporation allows trades from different marketplaces to be cleared and settled through the Corporation.

B. Settlement of Option Exercises and Assignments—**“E&A”** **and Settlement of Stock Futures Reaching Maturity**

Through an arrangement **(the “Accord”)** with **The** Options Clearing Corporation (“OCC”), **Members which have entered into agreements with the OCC Participating Members (defined below)** may settle **regular way through the facilities of the Corporation** security and money obligations arising out of **(i) the exercise or assignment of an option, and (ii) the maturity of a stock futures contract through the facilities of the Corporation (collectively, “E&A/Delivery Transaction”); provided that (x) the E&A/Delivery Transaction is between two Participating Members, and (y) securities to be delivered or received in such settlement are either (1) CNS Securities, or (2) Balance Order Securities. The recording and reporting of such transactions is similar to those set forth in Procedure II.**

**A “Participating Member” is (i) a Member that is also a member firm of OCC, as separately defined by the rules of that entity (“OCC Member”); (ii) a Member that has been appointed by an OCC Member to effect settlement of E&A/Delivery Transactions through the Corporation on the appointing OCC Member’s behalf; (iii) an OCC Member that has appointed a Member to effect settlement of E&A/Delivery Transactions through the Corporation on its behalf; (iv) the Canadian Depository for Securities Limited (“CDS”); or (v) a Canadian clearing firm that is an OCC Member and settles activity at the Corporation through an identifiable subaccount in the account at the Corporation of CDS in which CDS effects settlement on behalf of such firm. Only Participating Members that are Members identified in (i), (ii), and (iv) above shall be named as counterparties on E&A/Delivery Transactions delivered to the Corporation pursuant to the Accord.**

A **Participating Member which that** wishes to utilize this **Service** must **advise the Corporation and** execute an agreement with OCC in the form acceptable to OCC. **OCC shall notify the Corporation of all Participating Members that have executed such agreements.**

**Unless otherwise agreed between OCC and the Corporation, E&A/Delivery Transactions are data is** received by the Corporation from OCC **on each day on which both the Corporation and OCC are open for accepting trades for clearance. a locked-in basis and Subject to the paragraph below, the Corporation’s guarantee pursuant to Addendum K shall become effective for each E&A/Delivery Transaction when the Required Deposits to the Clearing Fund,**



after taking into account that E&A/Delivery Transaction, are received by the Corporation from all Participating Members.

If (i) a Participating Member has failed to satisfy its Clearing Fund obligations to the Corporation pursuant to Procedure XV, or (ii) the Corporation has declined or ceased to act for a Participating Member pursuant to these Rules prior to the time that the Corporation's guarantee of such Participating Member's E&A/Delivery Transactions become effective (such Participating Member, a "Defaulting Participating Member"), then none of the E&A/Delivery Transactions involving such defaulting Participating Member for which the Corporation's guarantee pursuant to Addendum K has not yet become effective shall be guaranteed by the Corporation, and all such E&A/Delivery Transactions shall be exited out of the CNS Accounting Operation or the Balance Order Accounting Operation, as applicable, unless otherwise agreed between OCC and the Corporation. The Corporation shall have no further obligation regarding the settlement of the exited E&A/Delivery Transactions, other than such obligations as the Corporation may have pursuant to its arrangement with OCC, and the non-defaulting Participating Members' Required Deposit to the Clearing Fund will be recalculated excluding the exited E&A/Delivery Transactions.

E&A/Delivery Transactions are routed to the Balance Order Accounting Operation or the CNS Accounting Operation and are is reported to Members on such reports and in such formats as determined by the Corporation from time to time.

Exercised calls and assigned puts appear as purchases. Exercised puts and assigned calls appear as sells. Physical delivery of matured futures appear as purchases or sells.

The date of the maturity or exercise/assignment at OCC is recorded as the trade date for the maturity or exercise/assignment. The Settlement Date for such transactions is three days later. If the exercise occurs on a Saturday during exercise weekend, the preceding OCC business day is the trade date.

Regarding any E&A/Delivery Transaction submitted to the Corporation by OCC,

(1) if and to the extent that a security to be delivered and received in settlement of such E&A/Delivery Transaction is not a CNS Security or a Balance Order Security, such transaction shall be treated as a trade-for-trade transaction and the Corporation's guarantee pursuant to Addendum K shall not apply to these transactions; or

(2) if and to the extent that such E&A/Delivery Transaction is not submitted to the Corporation for regular way settlement, such transaction shall be processed in accordance with these Rules, as applicable.

~~The Corporation may require a special mark-to-market payment from Members as a result of such transactions being entered on its records.~~

~~Exercises and assignment transactions are routed to the Balance Order Accounting Operation or the CNS Accounting Operation.~~

~~If for any reason the Corporation ceases to act for a Member or ceases to clear a particular security, the Corporation may refuse to accept Interface Clearing input for such Member or such security.~~

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PROCEDURE XV. CLEARING FUND FORMULA AND OTHER MATTERS<sup>1</sup>

I.(A) Clearing Fund Formula for Members

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(1) For CNS Transactions

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(b) The net of each day's difference between (x) the contract price of such Member's Regular Way, When-Issued and When-Distributed net positions for transactions not submitted through the ID Net service that have not yet passed Settlement Date and its fail positions, and (y) the Current Market Price for such positions<sup>2</sup> (such difference to be known as the "Regular Mark-to-Market"); provided that: (i) ~~the Corporation shall exclude from this calculation any trades for which the Corporation has, under a Clearing Agency Cross-Guaranty Agreement, either obtained coverage for such difference (if the sum of the differences for the trades subject to the agreement is a positive number) or undertaken an obligation to provide coverage for such difference (if the sum of the differences for trades subject to the agreement is a negative number),~~ (ii) the Corporation may, but shall not be required to, exclude from this calculation any shares delivered by the Member in the night cycle to satisfy all or any portion of a short position; and (iii) that if the Member is an ID Net Subscriber and if the value of the Regular Mark-to-Market as computed above is a positive number, then the value of the Regular Mark-to-Market shall be zero;

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(2) For Balance Order Transactions

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(b) The net of each day's difference between the contract price of such Member's Net Balance Order Unsettled Positions, and the Current Market Price for such positions ~~(such difference to be known as the "Regular Mark-to-Market"), provided that the Corporation shall exclude from this calculation any trades for which the Corporation has, under a Clearing Agency Cross-Guaranty Agreement, either obtained coverage for such difference (if the sum of the differences for the trades subject to the agreement is a positive number) or undertaken an obligation to provide coverage for such~~

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<sup>1</sup> All calculations shall be performed daily or, if the Corporation deems it appropriate, on a more frequent basis.

<sup>2</sup> For fail positions, the contract price used for this purpose is the prior day's Market Price.

~~difference (if the sum of the differences for trades subject to the agreement is a negative number);~~

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