

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-68712; File No. SR-OCC-2012-23]

### Self-Regulatory Organizations; The Options Clearing Corporation; Order Approving Proposed Rule Change To Accommodate Certain Physically-Settled Options on U.S. Treasury Securities

January 23, 2013.

#### I. Introduction

On November 30, 2012, The Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change SR-OCC-2012-23 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> The proposed rule change was published for comment in the **Federal Register** on December 17, 2012.<sup>3</sup> The Commission received no comment letters. This order approves the proposed rule change.

#### II. Description of the Proposed Rule Change

The purpose of this proposed rule change is to accommodate the clearing of physically-settled options on certain U.S. Treasury notes and U.S. Treasury bonds (“Treasury Options”) traded by NASDAQ OMX PHLX, LLC (“PHLX”).<sup>4</sup> OCC’s current By-Laws and Rules (collectively, “Rules”) accommodate options on Treasury securities, but the options on Treasury securities contemplated by the Rules are no longer traded and are different from the Treasury Options that PHLX intends to trade in certain respects. Accordingly, OCC is amending the Rules, as described below, to accommodate such Treasury Options as well as to streamline Chapter XIV of its rulebook by re-numbering certain rules and deleting unused and “reserved” rules.

Since PHLX Treasury Options are limited to European-style options on Treasury notes and bonds with a unit of trading of \$10,000, OCC is removing provisions and references within Chapter XIV of the Rules to American-style options on Treasury securities, Treasury bills as an eligible underlying interest for options on Treasury

securities, and “mini options” on Treasury securities. In addition, OCC is removing from the Rules the defined term “adjusted exercise price,” which related only to options on Treasury bills and consequently is no longer needed, and is updating other definitions within the Rules to reflect the limiting of the underlying interests for Treasury Options to Treasury bonds and notes. Furthermore, since OCC is not currently permitting escrow deposits to be made in connection with the clearing of Treasury Options, it is removing related provisions in Section 2 of Article XIII.

OCC generally will apply current expiration date exercise procedures to Treasury Options, and will require delivery settlement for exercised and assigned Treasury Options to be effected on a broker-to-broker basis through the Fixed Income Clearing Corporation (“FICC”).<sup>5</sup> As not all OCC clearing members are participants of the Government Securities Division (“GSD”) of FICC, OCC is permitting clearing members to designate, with proper advance notice to OCC, a representative that is a GSD participant who would be responsible for inputting trade information into FICC’s systems for delivery settlement purposes.<sup>6</sup>

On the expiration date for a Treasury Option, OCC will produce an exercise and assignment report identifying the delivering and receiving clearing members and other relevant delivery information. Clearing members that are obligated to purchase or sell Treasury securities as a result of the exercise or assignment of positions in Treasury Options will be required to submit the terms of such trades to FICC’s real time trade matching system. If the trade information submitted by the delivering and receiving clearing member matches within FICC’s system, FICC becomes obligated to guarantee settlement of the trade pursuant to FICC’s rules, at the point in time at which FICC makes available to the delivering and receiving clearing members a report indicating the trade has been compared. At that time, OCC’s obligation to guarantee delivery settlement will be terminated. Delivery settlement through FICC includes delivery of the underlying securities against payment of the aggregate purchase price increased by the amount of accrued interest. If a trade does not match, the delivering and receiving OCC

clearing members will be required to notify OCC within such time as OCC may specify of such failure on the first business day after the expiration date. If no such notification is made within the deadline, pursuant to proposed Rule 1403(d), OCC’s obligation to guarantee settlement will be extinguished as of such deadline, regardless of whether settlement was actually completed.

In the event OCC is given timely notification of a failure to match on the first business day after the expiration date, the clearing members would be required to attempt to resolve the failure such that settlement could occur through FICC by a deadline specified by OCC on the second business day following the expiration date. If the failure is not resolved and the trade has not matched by the deadline on the second business day after the expiration date, the delivering and receiving OCC clearing members will be required to notify OCC within such time as OCC may specify of such failure. If no such notification is made within the deadline, pursuant to proposed Rule 1404(a), OCC’s obligation to guarantee settlement will be extinguished as of such deadline, regardless of whether settlement was actually completed.

If OCC receives timely notification, pursuant to proposed Rule 1404(a), that the second submission attempt at FICC failed to result in a match, OCC will assess and pay damages, if any, incurred by the delivering or receiving clearing member, as applicable, in connection with the failure to match. OCC will also be authorized to debit the amount of such damages from the account of the delivering or receiving clearing member, as applicable.

Under Rule 1404, in the event the non-defaulting clearing member buys or sells the underlying Treasury security, the non-defaulting clearing member will be required to promptly notify OCC of the price paid or received, as applicable, and OCC will take this information into account in assessing damages. However, OCC will not be bound to accept these prices in assessing damages, and will be able to make an independent determination of damages. Proposed Rule 1404 provides that OCC’s determination of damages is at OCC’s sole discretion, final, and binding on all parties. Such “failure to match” procedures will limit OCC’s liability in the event of a default by one of its clearing members.

OCC will collect and hold margin from clearing members with Treasury Option delivery or receipt obligations until the exercise settlement date, unless OCC receives notification of a failure to match, in which case OCC will

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

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

<sup>3</sup> Securities Exchange Act Release No. 68403 (December 11, 2012), 77 FR 74705 (December 17, 2012).

<sup>4</sup> See Securities Exchange Act Release No. 67976 (October 4, 2012), 77 FR 61794 (October 11, 2012) (SR-Phlx-2012-105).

<sup>5</sup> Clearing members interested in Treasury Options have advised OCC that it would be operationally more efficient for them if delivery settlement were effected in this manner.

<sup>6</sup> OCC has no obligation to such designated representative and is harmless against any claims based on the designated representative’s actions or delays in acting or failures to act.

continue to hold margin until either the trade is deemed settled or damages have been assessed and paid to the non-defaulting clearing member.

Rule 1405 clarifies that OCC may pursue disciplinary action against clearing members who fail to discharge the delivery, payment, and notification obligations as set forth in Rules 1403 and 1404.

In addition to the above changes relating to the terms of and settlement process for Treasury Options, OCC is revising Section 5 of Article XIII of the By-Laws regarding the handling of shortages of Treasury Securities. These revisions provide OCC with broader discretion in determining whether a shortage exists and simplify the procedures to be used in this situation.

### III. Discussion

Section 17A(b)(3) (F) of the Act<sup>7</sup> requires that, among other things, that the rules of a clearing agency are designed to promote the prompt and accurate clearance and settlement of securities transactions, and to the extent applicable derivative agreements, contracts, and transactions, to safeguard securities and funds in its custody or control or for which it is responsible, and to protect investors and the public interest. The proposed rule change accomplishes these purposes, by among other things, updating OCC's existing rule provisions to accommodate Treasury Options, as proposed for trading by PHLX, and implementing a settlement process designed to minimize the risks of settlement failures for investors. Furthermore, Section 17A(a)(2)(A)(ii) of the Act<sup>8</sup> directs the Commission to facilitate the establishment of linked and coordinated facilities for clearance and settlement of transactions in securities and securities options. The proposed rule change accomplishes this end by utilizing the existing infrastructure of two clearing agencies (OCC and FICC) to create a more operationally efficient exercise settlement process for Treasury Options, traded by PHLX.

### IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposal is consistent with the requirements of the Act and in particular with the requirements of Section 17A of the Act<sup>9</sup> and the rules and regulations thereunder.

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>10</sup> that the proposed rule change (File No. SR–OCC–2012–23) be and hereby is approved.<sup>11</sup>

For the Commission by the Division of Trading and Markets, pursuant to delegated authority.<sup>12</sup>

**Kevin M. O'Neill,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–68721; File No. SR–NASDAQ–2013–008]

### Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Amend Rule 5710

January 24, 2013.

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 January 10, 2013, The NASDAQ Stock Market LLC (“NASDAQ” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II, below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

#### I. Self-Regulatory Organization's Statement of the Terms of the Substance of the Proposed Rule Change

The Exchange proposes to amend Rule 5710 so that the Exchange may list Linked Securities<sup>3</sup> that provide for three times accelerated payment at maturity. The Exchange requests that the Commission waive the 30-day operative delay period contained in Exchange Act Rule 19b–4(f)(6)(iii).<sup>4</sup> The text of the proposed rule change is available at <http://nasdaq.cchwallstreet.com/>, at the Exchange's principal office, and at the Commission's Public Reference Room.

<sup>10</sup> 15 U.S.C. 78s(b)(2).

<sup>11</sup> In approving the proposed rule change, the Commission considered the proposal's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>12</sup> 17 CFR 200.30–3(a)(12).

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

<sup>2</sup> 17 CFR 240.19b–4.

<sup>3</sup> For a discussion of Linked Securities, see Rule 5710.

<sup>4</sup> 17 CFR 240.19b–4(f)(6)(iii).

#### II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange 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 Exchange has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

##### A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

###### 1. Purpose

The purpose of this proposed rule change is to amend Rule 5710(d) so that the Exchange may list Linked Securities that provide for three times accelerated payment at maturity.<sup>5</sup> In changing one word in Rule 5710, the Exchange is conforming its rule to the established listing rules of other exchanges.

This proposed amendment to Rule 5710(d) is based, word-for-word, on NYSE Arca (“Arca”) Equities Rule 5.2(j)(6)(A)(d) and NYSE Section 703.22(B)(6) of the Listed Company Manual. NASDAQ, Arca, and NYSE all have rule provisions stating that pursuant to Rule 19b–4(e) under the Act<sup>6</sup> a loss or negative payment at maturity of a Linked Security<sup>7</sup> may be accelerated by a multiple of the performance of an underlying asset (known as the “acceleration provision”). However, in Rule 5710 NASDAQ sets the multiple for the acceleration provision at “twice”;<sup>8</sup> whereas Arca and NYSE both set the acceleration

<sup>5</sup> The proposal is applicable only to non-option products.

<sup>6</sup> 17 CFR 240.19b–4(e).

<sup>7</sup> Where NASDAQ refers to “Linked Securities” in its Rule 5710, NYSE and Arca refer to these products as “Index-Linked Securities.” On all exchanges, Linked Securities are based on the performance of various Reference Assets. For a more detailed discussion of Reference Assets, see Rule 5710.

<sup>8</sup> See Rule 5710(d). See also Securities Exchange Act Release Nos. 59663 (March 31, 2009), 74 FR 15552 (April 6, 2009) (SR–NASDAQ–2009–018) (notice of filing and immediate effectiveness relating to revisions and restructuring of the NASDAQ listing rules, and transference of Rule 5710(d) from Rule 4420(m)); and 57269 (February 5, 2008), 73 FR 8092 (February 12, 2008) (SR–NASDAQ–2008–08) (order approving listing standards in Rule 4420(m) to allow *twice* (2x) the performance of the underlying index, indexes, or Reference Asset).

<sup>7</sup> 15 U.S.C. 78q–1(b)(3)(F)

<sup>8</sup> 15 U.S.C. 78q–1(a)(2)(ii).

<sup>9</sup> 15 U.S.C. 78q–1.