

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-88310; File No. SR-OCC-2020-001)

March 2, 2020

Self-Regulatory Organizations; The Options Clearing Corporation; Order Approving Proposed Rule Change to Modify the Fees for Exercise Notices Submitted after the Deadlines and to Change the Deadline for Submitting a Late Exercise Notice on Non-Expiration Dates

I. INTRODUCTION

On January 14, 2020, the Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change SR-OCC-2020-001 (“Proposed Rule Change”) pursuant to Section 19(b) of the Securities Exchange Act of 1934 (“Exchange Act”)¹ and Rule 19b-4² thereunder to modify the fee imposed for submitting a late exercise notice and change the deadline by which such a notice must be submitted on non-expiration dates.³ The Proposed Rule Change was published for public comment in the Federal Register on January 30, 2020.⁴ The Commission has received no comments regarding the Proposed Rule Change. This order approves the Proposed Rule Change.

II. BACKGROUND

OCC’s rules require Clearing Members to submit option exercise notices within the timeframes prescribed by OCC. OCC’s rules provide for an exception process to accommodate exercise notices submitted outside of such timeframes solely for the purpose of correcting a bona

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Notice of Filing infra note 4, at 85 Fed. Reg. 5491.

⁴ Securities Exchange Act Release No. 88030 (Jan. 24, 2020), 85 Fed. Reg. 5491 (Jan. 30, 2020) (SR-OCC-2020-001) (“Notice of Filing”).

vide error on the part of a Clearing Member or customer.⁵ OCC's process for accommodating late exercise notices includes, among other things, a late filing fee and a final deadline by which any such notice must be received by OCC. OCC proposes to amend its Rules 801 and 805 to modify the fees for exercise notices submitted after the deadlines by which all option exercise notices must be submitted and to change the deadline for submitting a late exercise notice on non-expiration dates.⁶

OCC's Rule 801 governs the exercise of an options on days other than the option's expiration date. OCC's Rule 805 governs the exercise of an option on the option's expiration date. Under OCC's Rule 801(d), the filing of a late exercise notice by a Clearing Member may be deemed a violation of OCC's procedures and may subject the Clearing Member to disciplinary action. Additionally, under OCC's Rule 801(d) and Rule 805(g), a Clearing Member submitting a late exercise notice is liable to OCC for a \$75,000 fee per line item listed on a late exercise notice.⁷

OCC observed that the Clearing Members submitting late exercise notices in 2017 and 2019 captured dividends on the securities underlying the late exercised options, thereby securing the financial gains associated with such captured dividends.⁸ Further, OCC observed that the

⁵ See OCC Rules 801 and 805, available at https://www.theocc.com/components/docs/legal/rules_and_bylaws/occ_rules.pdf.

⁶ OCC did not propose to change deadlines related to the late exercise of options on an option's expiration date.

⁷ A line item is an exercise instruction which includes the account, series, and quantity to be exercised.

⁸ See Notice of Filing, 85 Fed. Reg. at 5492.

amount of dividends captured ranged from \$93,600 to \$436,800.⁹ OCC has previously stated that the late exercise fee is intended as an incentive for Clearing Members to be especially diligent in processing exercise notices and to improve back office procedures while at the same time preserving their ability to correct bona fide operational errors.¹⁰

On November 9, 2017, OCC discussed late exercise notices submitted in 2017 at its OCC Roundtable, an OCC-sponsored advisory group comprised of representatives from OCC's participant exchanges, a cross-section of OCC Clearing Members, and OCC staff.¹¹ The OCC Roundtable participants noted the dollar amount at issue in connection with late exercises received in 2017, which reflected the amount of dividends received by the person submitting the late exercise as a result of receiving the underlying shares. As a result of these discussions, Roundtable participants agreed that an increase in the late exercise fee from the current \$75,000 fee per line item to \$250,000 fee per line item would be appropriate and in a range to incentivize Clearing Members to be especially diligent in processing exercise notices while at the same time still allowing firms to correct bona fide errors.¹²

OCC's Rule 801(d) defines the deadline for submitting late exercise notices for exercises other than at expiration. Under its current rules, OCC will not accept a late exercise notice received after 6:30 a.m. CT, and Clearing Members assigned late exercises must be notified by

⁹ See Notice of Filing, 85 Fed. Reg. at 5492, n. 10. OCC also stated that the amount of late exercises notices received since 2017 was significantly more than the preceding seven years. See Notice of Filing, 85 Fed. Reg. at 5492.

¹⁰ See Securities Exchange Act Release No. 57584 (Mar. 31, 2008), 73 Fed. Reg. 18844 (Apr. 7, 2008) (SR-OCC-2007-016); Notice of Filing, 85 Fed. Reg. at 5492.

¹¹ See Notice of Filing, 85 Fed. Reg. at 5492.

¹² See Notice of Filing, 85 Fed. Reg. at 5492.

8:00 a.m. CT.¹³ OCC's rules, therefore, may provide OCC with as little as 90 minutes to accommodate an exception to OCC's standard option exercise processes. OCC's exception process requires the (1) review of Clearing Member positions, (2) escalation of the request to submit a late exercise notice to senior management, (3) random assignment of late exercised positions to Clearing Members, and (4) communication to assigned Clearing Members.¹⁴ OCC represented that the 90-minute period from 6:30 a.m. to 8:00 a.m. CT was a narrow window for OCC staff to complete these steps, which are necessary to properly process late exercises and assignments, without delays.¹⁵ As a result, in addition to increasing the late exercise fee as discussed above, OCC proposes to change the deadline for submission of late exercises to 6:00 a.m. CT to provide an additional 30 minutes of processing time. The OCC Roundtable discussed the proposal described above and agreed that it would be appropriate and in a range to incentivize Clearing Members to be especially diligent in processing exercise notices while at the same time still allowing firms to correct bona fide errors.¹⁶

III. DISCUSSION AND COMMISSION FINDINGS

Section 19(b)(2)(C) of the Exchange Act directs the Commission to approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of the Exchange Act and the rules and regulations thereunder

¹³ See OCC Rule 801(d)(2), available at https://www.theocc.com/components/docs/legal/rules_and_bylaws/occ_rules.pdf.

¹⁴ See Notice of Filing, 85 Fed. Reg. at 5492.

¹⁵ See Notice of Filing, 85 Fed. Reg. at 5492.

¹⁶ See Notice of Filing, 85 Fed. Reg. at 5492.

applicable to such organization.¹⁷ After carefully considering the Proposed Rule Change, the Commission finds that the proposal is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to OCC. More specifically, the Commission finds that the proposal is consistent with Sections 17A(b)(3)(D) and 17A(b)(3)(F) of the Exchange Act.¹⁸

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

Section 17A(b)(3)(D) of the Exchange Act requires that the rules of a clearing agency provide for the equitable allocation of reasonable dues, fees, and other charges among its participants.¹⁹ Based on its review of the record, the Commission believes that the proposed increase in the late exercise notice fee is reasonable for the reasons described below.

As described above, under Rules 801(d) and 805(g), the filing of a late exercise notice may be deemed by OCC to be a violation of OCC's procedures and could subject the Clearing Member who submits such a filing to disciplinary action, as well as a \$75,000 late exercise fee. At the same time, OCC's Rules provide for a late exercise process designed to allow OCC to accommodate exceptions to its rules governing the option exercise process for bona fide errors. As noted above, OCC observed that, despite subjecting Clearing Members to the late exercise fee and potentially subjecting them to disciplinary action for violating OCC's procedures, Clearing Members were nevertheless filing late exercise notices, thereby securing the financial gains associated with the captured dividends on the securities underlying the late exercised options.

OCC proposes to increase the late exercise fee from \$75,000 to \$250,000 per line item.

¹⁷ 15 U.S.C. 78s(b)(2)(C).

¹⁸ 15 U.S.C. 78q-1(b)(3)(D) and 15 U.S.C. 78q-1(b)(3)(F).

¹⁹ 15 U.S.C. 78q-1(b)(3)(D).

As noted above, OCC's determination to increase the late exercise fee by this amount was based on discussions at the 2017 OCC Roundtable among representatives from OCC's participant exchanges, a cross-section of OCC Clearing Members, and OCC staff regarding a potential increase in the amount of the late exercise fee that would be appropriate and in a range to incentivize Clearing Members to be especially diligent in processing exercise notices while at the same time still allowing firms to correct bona fide errors.²⁰ As part of those discussions, Roundtable participants reviewed the dollar amounts at issue in connection with late exercises received in 2017, which reflected the amount of dividends received by the person submitting the late exercise as a result of receiving the underlying shares. Based on these discussions, the Roundtable participants agreed that an increase in the late exercise fee from the current \$75,000 fee per line item to \$250,000 fee per line item would be appropriate and in a range to accomplish the goals noted above.

The Commission understands that, as part of OCC's exception process, one of the purposes of the late exercise fee is to incent Clearing Members to be especially diligent in complying with OCC's Rules regarding processing exercise notices, while at the same time preserving the ability of Clearing Members to correct bona fide operational errors in those relatively rare instances when such a need arises.²¹ To that end, as noted above, OCC coordinated with relevant stakeholders to discuss the relevant information and determine the level of fees related to late exercise notices that would strike an appropriate balance between these goals. The Commission views OCC's efforts in this regard as reasonable. Likewise, given

²⁰ See Notice of Filing, 85 Fed. Reg. at 5492.

²¹ See Securities Exchange Act Release No. 57584 (Mar. 31, 2008), 73 Fed. Reg. 18844 (Apr. 7, 2008) (SR-OCC-2007-016); Notice of Filing, 85 Fed. Reg. at 5492.

that dividends captured through the late exercise process in 2017 and 2019 ranged from \$93,600 to \$436,800, the Commission believes that OCC's proposal to adopt the consensus recommendation from the 2017 OCC Roundtable to raise the late exercise fee to \$250,000 is equally reasonable.

Taken together, and given the purpose of the late exercise fee and the financial incentives represented by such dividends, the Commission believes that the proposed increase to \$250,000 per line item for late exercise notices is reasonable and, therefore, is consistent with the requirements of Section 17A(b)(3)(D) of the Exchange Act.²²

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

Section 17A(b)(3)(F) of the Exchange Act requires, among other things, that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions.²³ Based on its review of the record, the Commission believes that the proposed change to the deadline for submitting late exercise notices is consistent with the promotion of prompt and accurate clearance and settlement of securities transactions for the reasons described below.

As described above, the late exercise notice process is designed to accommodate exceptions for bona fide errors to the routine options exercise process. OCC's current rules may provide as little as 90 minutes to process late exercise notices. Processing such notices requires a number of procedural steps, including the notification of Clearing Members affected by the random assignment of late exercises. The Commission believes that successful and timely completion of exercise and assignment processes is important to the prompt and accurate

²² 15 U.S.C. 78q-1(b)(3)(D).

²³ 15 U.S.C. 78q-1(b)(3)(F).

settlement of securities transactions. The Commission further believes that providing an additional 30 minutes to facilitate the processing of late exercises and assignments without delay would promote the prompt and accurate clearance and settlement of securities transactions and is, therefore, consistent with the requirements of Section 17A(b)(3)(F) of the Exchange Act.²⁴

IV. CONCLUSION

On the basis of the foregoing, the Commission finds that the Proposed Rule Change is consistent with the requirements of the Exchange Act, and in particular, the requirements of Section 17A of the Exchange Act²⁵ and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Exchange Act,²⁶ that the Proposed Rule Change (SR-OCC-2020-001) be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²⁷

J. Matthew DeLesDernier
Assistant Secretary

²⁴ 15 U.S.C. 78q-1(b)(3)(F).

²⁵ In approving this Proposed Rule Change, the Commission has considered the proposed rules' impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

²⁶ 15 U.S.C. 78s(b)(2).

²⁷ 17 CFR 200.30-3(a)(12).