



TO: ALL CLEARING MEMBERS
DATE: OCTOBER 09, 2019
SUBJECT: OPTIONS PROCESSING SEQUENCE

OCC intends to file a rule change with the SEC to amend OCC Rules 801 and 804 which will change the processing sequence to process closing sell transactions prior to exercises for securities options and commodity futures options in all account types. This proposed processing sequence will only become effective if and when OCC receives regulatory approval for the rule change. OCC’s current processing sequence for securities options and commodity futures options has exercises being processed prior to closing sell transactions. The current and proposed sequences are as follows:

Current Processing Sequence	Proposed Processing Sequence
Opening Buys Opening Sells Closing Buys Net Longs and Shorts for Net Accounts *Exercises *Closing Sells Assignments	Opening Buys Opening Sells Closing Buys *Closing Sells Net Longs and Shorts for Net Accounts *Exercises Assignments

Background

OCC’s current process was originally designed to help protect Clearing Members against the risk that an erroneously coded transaction would prevent the exercise of a customer’s long position. Since most customer positions are held on a gross basis, a miscoded sell transaction of one customer could potentially close out a long position in the same series of another customer, thereby preventing the Clearing Member from exercising that option on behalf of the customer. By processing closing sells after exercises, that risk was minimized.

Clearing Members’ proficiency in processing transactions has improved dramatically with many Clearing Members correcting these closing sell errors as they occur. Additionally, Clearing Members now have the ability to use various tools provided by OCC to confirm that submitted exercises have sufficient long positions. These include utilizing the On Demand Position file (ODP) to balance long positions vs. exercises and daily verification of the ENCORE Exercise screen for “Insufficient Longs” to ensure sufficient long positions exist for every exercise. With these tools and the advancement of processing

efficiencies, OCC and Clearing Members have determined that the protection provided by the current process is no longer required.

The Rule change was requested to help prevent Clearing Members from being alleged to have violated certain exchange rules that require customers to only exercise “outstanding” net long positions.¹ By processing all buys and sells prior to exercises, the proposed change would address these concerns by creating a systemic way at OCC to ensure that only net long positions will be exercised.

OCC will provide Clearing Members the opportunity to test the updated Options Processing Sequence in the OCC Daily UAT environment starting on approximately December 1, 2019. Clearing members can participate in testing and viewing Monday – Friday during this time.

If Daily UAT connectivity has not been previously established, please submit a request using our online form (<http://optionsclearing.com/webapps/cert-test-services>) indicating the purpose of the request is **Options Processing Sequence Testing**. Please note new connectivity can take 7 – 10 days.

OCC will post another memo once the rule is filed with the SEC.

If you have any questions regarding this memorandum, please contact the Member Services Help Desk at the following numbers: 800-544-6091 or 800-621-6072. Within Canada, please call 800-424-7320. Clearing members may also e-mail OCC at memberservices@theocc.com.

¹ As an example, BATS Rule 23.1(a) provides that, “an outstanding options contract may be exercised during the time period specified in the Rules of [OCC] by the tender to [OCC] of an exercise notice in accordance with the Rules of [OCC].” BATS Rule 16.1(a)(43) defines “outstanding” as “an options contract which has been issued by [OCC] and has neither been the subject of a closing writing transaction nor has reached its expiration date.”