

accounts.⁴ The UCC amendments established new rules specifically tailored to govern the “indirect holding system” for securities and certain other investment property. Under these rules, OCC may obtain an automatically perfected, first-priority security interest in assets in market-maker accounts through provisions in OCC’s By-Laws or Rules. No grant of a security interest from the market-maker to OCC is required.

Under the UCC amendments, OCC and its clearing members are “securities intermediaries,”⁵ and an OCC-issued option is a “financial asset.”⁶ A person acquires a “security entitlement”⁷ and becomes an “entitlement holder”⁸ when a securities intermediary credits a financial asset to that person’s account.⁹ Thus, OCC’s clearing members acquire security entitlements against OCC when OCC credits positions to the clearing members’ accounts. Similarly, the clearing members’ customers (including market-makers) acquire security entitlements against the clearing member with respect to positions carried for the accounts of those customers on the books of the clearing member. In the first case, the clearing member is the entitlement holder, and OCC is the securities intermediary. In the second case, the customer (or market-maker) is the entitlement holder, and the clearing member is the securities intermediary. In this instance, the customers’ security entitlement against the clearing member is a different item of property from the clearing member’s security entitlement against OCC.¹⁰

In order for OCC to acquire a perfected security interest in clearing members’ security entitlements, OCC must obtain “control” over the entitlements or the “securities account”

in which they are held.¹¹ UCC 8–106(e) provides that the securities intermediary has control “[i]f an interest in a security entitlement is granted by the entitlement holder to the entitlement holder’s own securities intermediary.” As proposed, the revised rule would state that the clearing member (*i.e.*, the entitlement holder) agrees, and represents that it has obtained the agreement of each market-maker whose positions and transactions are included in the account and that OCC (*i.e.*, the securities intermediary) has a lien on long positions and margin in each market-maker account. Consequently, OCC will have a security interest perfected by control in the security entitlements in each market-maker account whether or not it has obtained a signed agreement from each market-maker.

Furthermore, OCC’s security interest has priority over any competing interests. “A security interest in a security entitlement or a securities account¹² granted to the debtor’s own securities intermediary has priority over any security interest granted by the debtor to another secured party.”¹³

Because it remains the case that as between a clearing member and its customers (including a market-maker), the clearing member has a duty to obtain the customer’s consent before subjecting the customer’s securities to a security interest or taking certain other actions potentially affecting the customer’s interests,¹⁴ the proposed rule continues to require clearing members

to contain specified agreements from market-maker and also to require them to represent to OCC that such agreements have in fact been obtained. Those clearing members that choose to continue to use an existing form of market-maker account agreement will be permitted to do so, but OCC will also permit the agreement required under Section 3 of Article VI of its By-Laws to be incorporated into a clearing member’s own forms of account agreements to the extent that the clearing member chooses to do so.

OCC also proposes to add two new items to the Interpretations and Policies to Article VI, Section 3 of its By-Laws. The first sentence of proposed Interpretation .02 sets forth a representation and warranty that the clearing member has obtained the agreement of each person for whom a transaction is effected in any account of the clearing member at OCC pursuant to provisions of Section 3, including the security interest in the account that is granted by the clearing member to OCC, and that the inclusion of the person’s transactions and positions in that type of account is otherwise permitted by applicable law. This representation would apply not only to market-maker accounts and JBO participant accounts¹⁵ but also to the firm account, pledge accounts, securities customer accounts, cross-margining accounts, and segregated futures accounts that are provided for under paragraphs (a) and (d) through (g) of Section 3, respectively. OCC has never required that a specified form of agreements be obtained by clearing members from persons whose transactions are included in these other types of accounts. Nevertheless, Rule 15c3–3 and the Commission’s hypothecation rules, Rule 8c–1 and Rule 15c2–1, as well as certain state laws require that certain consents and agreements be obtained, such as consent to the commingling of a customer’s securities with the securities of another customer. These comments are included in the account documentation normally obtained by brokers from their customers and are the responsibility of the broker.

The final sentence of Interpretation .02 is intended to make clear that the rights of OCC, including its security interest, in any account of the clearing member with OCC are enforceable in

⁴ OCC did not propose to eliminate the requirement that clearing members file market-maker account agreements with OCC immediately after the adoption of the UCC amendments because that requirement was not inconsistent with the UCC amendments and because the UCC amendments were not immediately adopted in all U.S. jurisdictions. Because OCC is expecting an increase in Market-Maker account openings as a result of security futures trading, it is now a business priority for OCC to eliminate the requirement in order to relieve administrative burdens for both OCC and its clearing members.

⁵ UCC 8–102(a)(14).

⁶ UCC 8–102(a)(9)(ii) and 8–103(e).

⁷ UCC 8–102(a)(17).

⁸ UCC 8–102(a)(7).

⁹ UCC 8–501(b)(1).

¹⁰ Prefatory Note to UCC Article 8, Section III.C. states, “For purposes of Article 8 analysis, the customer’s security entitlement against the broker or bank custodian is a different item of property from the security entitlement of the broker or bank custodian against the clearing corporation.”

¹¹ UCC 9–314(a) and 9–106(a).

¹² UCC 8–501(a) defines “securities account” to mean “an account to which a financial asset is or may be credited in accordance with an agreement under which the person maintaining the account undertakes to treat the person for whom the account is maintained as entitled to exercise the rights that comprise the financial asset.” UCC 9–102(a)(14) defines “commodity account” as an account maintained by a commodity intermediary in which a commodity contract is carried for a commodity customer.” Accounts established under Section 3 of OCC’s By-Laws would ordinarily be “securities accounts,” but certain accounts might be construed as commodity accounts or as both securities accounts and commodity account given that OCC may clear commodity contracts and security futures as well as security options. In any case, the Article 9 rules governing perfection and priority of security interests in commodity accounts and assets contained therein are substantively identical to those governing securities accounts and assets therein because all are included in the UCC 9–102(a)(49) definition of “investment property” to which those rules apply. To the extent that an account if a “commodity account,” OCC will fail within the definition of a “commodity intermediary” under UCC 9–102(a)(17).

¹³ UCC 9–328(3).

¹⁴ See UCC 8–504(b), which states that a securities intermediary may not grant any security interests in a financial asset is it obligated to maintain on behalf of an entitlement holder except as otherwise agreed by the entitlement holder.

¹⁵ Under Article I, Section 1, of OCC’s By-Laws a “JBO participant account” means an account established by a clearing member which is confined to exchange transactions cleared and positions carried by the clearing member on behalf of JBO participants for whom the clearing member has filed a JBO participant account agreement with OCC.