

Commission is granting approval of the proposed rule change.

II. Description

The purpose of the rule change is to amend Article VI, Section 3 of OCC's By-Laws and Chapter XI, Rule 1105 of OCC's Rules to eliminate the requirement that a clearing member must obtain a specified form of account agreement from each market-maker for whom it carries an account and must submit the agreement to OCC for approval. OCC believes that such submissions to OCC are no longer necessary to perfect its security interest in clearing members' market-maker accounts under the Uniform Commercial Code ("UCC") and are administratively burdensome for OCC and its clearing members.

The rule change also adds two new interpretive statements to Article VI, Section 3. Interpretation .02 clarifies the application to OCC clearing accounts of certain UCC amendments to Article 8 and to Article 9. Interpretation .03 clarifies that OCC's lien on positions in clearing member accounts extends to short security futures positions, as well as all other assets, and that OCC's lien secures clearing member obligations on long security futures positions, as well as all other obligations arising from the applicable account or accounts.

1. Background

Article VI, Section 3, of OCC's By-Laws specifies the types of clearing accounts that a clearing member may have at OCC, including accounts in which a clearing member may carry positions of market professionals such as options market-makers, JBO participants,³ and stock specialists (referred to collectively herein as "market-makers" and "market-maker accounts"). Clearing members that maintain market-maker accounts at OCC must, according to the current provisions of Article VI, Section 3, obtain and submit to OCC for approval certain agreements from each market-maker whose funds and positions are included in such market-maker accounts. The principal reason for requiring the filing of these agreements

with OCC was to ensure that OCC's security interest in and setoff rights against long option positions and assets deposited as margin in market-maker accounts would be protected under the UCC as it existed prior to the 1994 UCC amendments in the event of a clearing member insolvency.

OCC currently requires that a clearing member file with OCC a specified form of account agreement, executed by the clearing member and each market-maker included in the account, containing the required consents for the applicable type of market-maker account.⁴ Having to submit each of the agreements to OCC for OCC review is cumbersome and imposes administrative burdens on both clearing members and OCC staff. Moreover, OCC believes that there may be potential for confusion in the legal relationships established through these documents. Although the agreements are not intended to create contractual privity between OCC and the market-maker, OCC believes it might be possible to misinterpret the agreements as doing so.

2. Proposed Changes

Because of the UCC amendments in 1994, OCC believes it is no longer necessary to require clearing members to file market-maker account agreements with OCC in order to protect OCC's security interest in and setoff rights against funds and positions in market-maker accounts.⁵ The UCC amendments established new rules specifically tailored to govern the "indirect holding system" for securities and certain other investment property.⁶ Under these

⁴ While the content of the agreements may vary by type of market-maker account, all agreements specify OCC's right to a lien on all assets in the account, the right to carry positions "net," and the right to close out positions. Market-makers whose assets are carried at OCC in combined accounts with other market-makers are required to consent to the commingling of their positions with the positions of other market-makers. Because OCC's lien on all assets in a combined market-makers' account covers any obligation arising from the commingled account, assets attributable to one market-maker may be used by OCC to offset obligations of the clearing member that are attributable to the activity of a different market-maker.

⁵ 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.

⁶ Part 5 of Article 8 of the UCC describes the core of the package of rights of a person who holds a security through a securities intermediary.

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,"⁷ and an OCC-issued option is a "financial asset."⁸ A person acquires a "security entitlement"⁹ and becomes an "entitlement holder"¹⁰ when a securities intermediary credits a financial asset to that person's account.¹¹ OCC's clearing members acquire a security entitlement against OCC when OCC credits positions to their accounts. The clearing members' customers (including market-makers) acquire security entitlements against the clearing member with respect to positions carried for those customers on the books of the clearing member.

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.¹² 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."

OCC's revised by-law and rule will 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 of 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 account"¹³ granted to the debtor's own

⁷ UCC 8-102(a)(14).

⁸ UCC 8-102(a)(9)(ii) and 8-103(e).

⁹ UCC 8-102(a)(17).

¹⁰ UCC 8-102(a)(7).

¹¹ UCC 8-501(b)(1).

¹² UCC 9-314(a) and 9-106(a).

¹³ 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

³ Under Article I, Section 1 of OCC's By-Laws, a "JBO participant" is a registered broker-dealer that "(i) maintains a joint back office arrangement with a clearing member pursuant to the requirements of Regulation T promulgated by the Board of Governors of the Federal Reserve System; (ii) meets the requirements applicable to JBO participants as specified in exchange rules; and (iii) consents to having his exchange transactions cleared and positions carried in a JBO participants account." Unless the context requires otherwise, a JBO participant is a market-maker for purposes of OCC's By-Laws and all of OCC's Rules except for Chapter IV.