

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-88317; File No. SR-OCC-2020-801)

March 4, 2020

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of No Objection to Advance Notice Concerning a Master Repurchase Agreement as Part of OCC's Overall Liquidity Plan

I. INTRODUCTION

On January 10, 2020, the Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission (“Commission”) advance notice SR-OCC-2020-801 (“Advance Notice”) pursuant to Section 806(e)(1) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, entitled Payment, Clearing and Settlement Supervision Act of 2010 (“Clearing Supervision Act”)¹ and Rule 19b-4(n)(1)(i)² under the Securities Exchange Act of 1934 (“Exchange Act”)³ to enter into a committed master repurchase agreement with a bank counterparty to access a committed source of liquidity to meet its settlement obligations.⁴ The Advance Notice was published for public comment in the Federal Register on February 11, 2020,⁵ and the Commission has received no comments regarding the changes proposed in the Advance

¹ 12 U.S.C. 5465(e)(1).

² 17 CFR 240.19b-4(n)(1)(i).

³ 15 U.S.C. 78a et seq.

⁴ See Notice of Filing infra note 5, at 85 Fed. Reg. 7812.

⁵ Securities Exchange Act Release No. 88120 (Feb. 5, 2020), 85 Fed. Reg. 7812 (Feb. 11, 2020) (SR-OCC-2020-801) (“Notice of Filing”).

Notice. The Commission is hereby providing notice of no objection to the Advance Notice.

II. BACKGROUND⁶

OCC maintains cash and other liquid resources to help it ensure that it can meet its obligations in the event of a Clearing Member default. OCC's liquid resources have included access to a diverse set of funding sources, including a syndicated credit facility, a committed master repurchase program with institutional investors such as pension funds (the "Non-Bank Liquidity Facility"), and Clearing Member minimum cash Clearing Fund requirements.⁷ The confirmations⁸ under the Non-Bank Liquidity Facility, totaling \$1 billion, expired on January 6, 2020.⁹ To help ensure that OCC's total committed liquidity resources did not decrease following expiration of the \$1 billion Non-Bank Repo Facility, OCC previously sourced an additional \$500 million by exercising the accordion feature of its syndicated bank credit facility.¹⁰ In addition to that, OCC exercised its existing authority to temporarily increase the cash funding requirement in its Clearing Fund from \$3 billion to \$3.5 billion, which Clearing

⁶ Capitalized terms used but not defined herein have the meanings specified in OCC's Rules and By-Laws, available at <https://www.theocc.com/about/publications/bylaws.jsp>.

⁷ See Notice of Filing, 85 Fed. Reg. at 7812 (citations omitted).

⁸ A confirmation under a master repurchase agreement describes the terms of a transaction, including the purchased securities, purchase price, purchase date, repurchase date, and any additional terms or conditions not inconsistent with the master repurchase agreement.

⁹ See Notice of Filing, 85 Fed. Reg. at 7814 n. 19.

¹⁰ See Notice of Filing, 85 Fed. Reg. at 7814 n. 20.

Members were obligated to fund by January 6, 2020.¹¹ Taken together, these two liquidity sources fully replaced the \$1 billion Non-Bank Repo Facility prior to its expiration on January 6, 2020. Now, OCC proposes to access an additional committed source of liquidity to meet its settlement obligations by entering into a committed master repurchase agreement (“MRA”) with a bank counterparty with confirmations totaling \$500 million (the “Bank Repo Facility”).¹²

The Commission previously reviewed and did not object to OCC’s execution of the Non-Bank Repo Facility, which was based on the same standard form master repurchase agreement as the MRA governing the proposed Bank Repo Facility.¹³ As with the Non-Bank Repo Facility, under the MRA, the securities eligible for transactions under the MRA would include U.S. government securities. Specifically, OCC would use securities included in the margin deposits of a suspended Clearing Member as well as

¹¹ See OCC Information Memo #46287, Revised Cash Requirement in Clearing Fund (Jan. 3, 2020), available at <https://www.theocc.com/webapps/infomeos?number=46287&date=202001&lastModifiedDate=01%2F03%2F2020+00%3A00%3A00>.

¹² Because the counterparty may be a bank with which OCC has existing relationships, in which case the proposed Bank Repo Facility could materially increase OCC’s exposure to the bank, the Commission requested and reviewed information about existing relationships and exposures. See Notice of Filing, 85 Fed. Reg. at 7812, n. 9 (stating that OCC provided additional information in a confidential Exhibit 3b). The Commission also reviewed information regarding OCC’s processes for monitoring such exposures. Id.

¹³ See e.g., Securities Exchange Act Release No. 76821 (Jan. 4, 2016), 81 Fed. Reg. 3208 (Jan. 20, 2016) (SR-OCC-2015-805); Securities Exchange Act Release No. 73979 (Jan. 2, 2015), 80 Fed. Reg. 1062 (Jan. 8, 2015) (SR-OCC-2014-809). Similar to the agreement underlying the Non-Bank Liquidity Facility, the materials terms of the MRA would be based on a standard form master repurchase agreement published by the Securities Industry and Financial Markets Association.

Clearing Fund contributions to access the Bank Repo Facility. The market value of the securities supporting each transaction under the Bank Repo Facility would be determined daily, and OCC would be obligated to provide additional securities as necessary in response to a fall in the market value of purchased securities. Similarly, the standard terms addressing an event of default under the MRA would be substantially similar to the terms of the agreement underlying the Non-Bank Liquidity Facility. Further, as part of establishing the Bank Repo Facility, OCC would review and monitor its counterparty's ability to meet obligations under the MRA.

Many of the terms of the MRA specifically tailored to the Bank Repo Facility would nonetheless be substantially similar to the terms of the agreement underlying the Non-Bank Liquidity Facility, including (1) the duration of the agreement; (2) the buyer's obligation to fund regardless of a material adverse change, such as the failure of a Clearing Member; (3) availability of funds within 60 minutes of OCC providing securities to the buyer; (4) a prohibition against rehypothecation of the purchased securities by the buyer; (5) OCC's option to terminate a transaction early and to specify a new repurchase date;¹⁴ (6) OCC's right to substitute any eligible securities for purchased securities; and (7) the use of a "mini-default" in lieu of declaring an event of default at the discretion of the non-defaulting party.¹⁵

¹⁴ The buyer would not have a similar right, but rather, would be permitted to terminate a transaction early only upon the occurrence of an event of default with respect to OCC.

¹⁵ For example, if the buyer fails to transfer purchased securities on the applicable repurchase date, rather than declaring an event of default, OCC may (1) if OCC has already paid the repurchase price, require the buyer to repay the repurchase price, (2) if there is a margin excess, require the buyer to pay cash or deliver purchased securities in an amount equal to the margin excess, or (3) declare that

Where necessary and appropriate, however, certain terms of the proposed MRA would differ from the terms of the agreement underlying the Non-Bank Liquidity Facility. For example, the Bank Repo Facility would include confirmations totaling \$500 million rather than \$1 billion.¹⁶ Other differences between the MRA and the agreement underlying the Non-Bank Liquidity Facility relate to the fact that OCC's counterparty for the Bank Repo Facility is a commercial bank rather than a pension fund. Specifically, unlike the terms underlying the Non-Bank Liquidity Facility, OCC would not require the Bank Repo Facility counterparty to maintain cash and investments in a designated account into which OCC has visibility.¹⁷ Such a designated account was necessary to facilitate prompt funding for the Non-Bank Liquidity Facility counterparties because they, unlike the Bank Repo Facility counterparty, were not commercial banks and therefore were not in the business of daily funding.¹⁸ Similarly, the MRA would not include terms related to a custodian other than the Bank Repo Facility counterparty because OCC's counterparty, as a commercial bank, would be capable of acting as custodian of the purchased securities.¹⁹

the applicable transaction, and only that transaction, will be immediately terminated, and apply default remedies under the MRA to only that transaction.

¹⁶ As described above, OCC has already sourced additional liquid resources through its syndicated credit facility that would cover the other half of the Non-Bank Liquidity Facility. Additionally, the establishment of the Bank Repo Facility would not preclude OCC from establishing other arrangements with different liquidity providers in the future.

¹⁷ See Notice of Filing, 85 Fed. Reg. at 7813 n. 16.

¹⁸ See id.

¹⁹ Based on information provided by OCC, the Commission understands that OCC's counterparty to the Bank Repo Facility, as a commercial bank, would custody the

III. COMMISSION FINDINGS AND NOTICE OF NO OBJECTION

Although the Clearing Supervision Act does not specify a standard of review for an advance notice, the stated purpose of the Clearing Supervision Act is instructive: to mitigate systemic risk in the financial system and promote financial stability by, among other things, promoting uniform risk management standards for systemically important financial market utilities (“SIFMUs”) and strengthening the liquidity of SIFMUs.²⁰

Section 805(a)(2) of the Clearing Supervision Act²¹ authorizes the Commission to prescribe regulations containing risk-management standards for the payment, clearing, and settlement activities of designated clearing entities engaged in designated activities for which the Commission is the supervisory agency. Section 805(b) of the Clearing Supervision Act²² provides the following objectives and principles for the Commission’s risk-management standards prescribed under Section 805(a):

- to promote robust risk management;
- to promote safety and soundness;
- to reduce systemic risks; and
- to support the stability of the broader financial system.

Section 805(c) provides, in addition, that the Commission’s risk-management standards may address such areas as risk-management and default policies and

purchased securities, and would provide to OCC information regarding purchased securities similar to what was required of a third-party custodian under the Non-Bank Repo Facility. See Notice of Filing, 85 Fed. Reg. at 7812, n. 9 (stating that OCC provided additional information in a confidential Exhibit 3b).

²⁰ See 12 U.S.C. 5461(b).

²¹ 12 U.S.C. 5464(a)(2).

²² 12 U.S.C. 5464(b).

procedures, among other areas.²³

The Commission has adopted risk-management standards under Section 805(a)(2) of the Clearing Supervision Act and Section 17A of the Exchange Act (the “Clearing Agency Rules”).²⁴ The Clearing Agency Rules require, among other things, each covered clearing agency to establish, implement, maintain, and enforce written policies and procedures that are reasonably designed to meet certain minimum requirements for its operations and risk-management practices on an ongoing basis.²⁵ As such, it is appropriate for the Commission to review advance notices against the Clearing Agency Rules and the objectives and principles of these risk management standards as described in Section 805(b) of the Clearing Supervision Act. As discussed below, the Commission believes the changes proposed in the Advance Notice are consistent with the objectives and principles described in Section 805(b) of the Clearing Supervision Act,²⁶ and in the Clearing Agency Rules, in particular Rules 17Ad-22(e)(7).²⁷

²³ 12 U.S.C. 5464(c).

²⁴ 17 CFR 240.17Ad-22. See Securities Exchange Act Release No. 68080 (October 22, 2012), 77 Fed. Reg. 66220 (Nov. 2, 2012) (S7-08-11). See also Securities Exchange Act Release No. 78961 (September 28, 2016), 81 Fed. Reg. 70786 (October 13, 2016) (S7-03-14) (“Covered Clearing Agency Standards”). The Commission established an effective date of December 12, 2016 and a compliance date of April 11, 2017 for the Covered Clearing Agency Standards. OCC is a “covered clearing agency” as defined in Rule 17Ad-22(a)(5).

²⁵ 17 CFR 240.17Ad-22.

²⁶ 12 U.S.C. 5464(b).

²⁷ 17 CFR 240.17Ad-22(e)(7).

A. Consistency with Section 805(b) of the Clearing Supervision Act

The Commission believes that the proposal contained in OCC's Advance Notice is consistent with the stated objectives and principles of Section 805(b) of the Clearing Supervision Act. Specifically, as discussed below, the Commission believes that the changes proposed in the Advance Notice are consistent with promoting robust risk management in the area of liquidity risk, promoting safety and soundness, reducing systemic risks, and supporting the stability of the broader financial system.²⁸

The Commission believes that the proposed changes are consistent with promoting robust risk management, in particular management of liquidity risk presented to OCC. OCC is a SIFMU.²⁹ As a SIFMU, it is imperative that OCC have adequate resources to be able to satisfy its counterparty settlement obligations, including in the event of a Clearing Member default.³⁰ As described above, OCC proposes to implement the Bank Repo Facility, in part, to address the expiration of the Non-Bank Facility and ensure that OCC's committed liquid resources remain at or above the amount that OCC has determined it needs to ensure that it has adequate resource to be able to satisfy its counterparty settlement obligations, after the Non-Bank Repo Facility expired on January 6, 2020. In addition, implementing the Bank Repo Facility would help OCC maintain its

²⁸ 12 U.S.C. 5464(b).

²⁹ See Financial Stability Oversight Council ("FSOC") 2012 Annual Report, Appendix A, available at <https://www.treasury.gov/initiatives/fsoc/Documents/2012%20Annual%20Report.pdf>.

³⁰ See Securities Exchange Act Release No. 73979 (Jan. 2, 2015), 80 Fed. Reg. 1062, 1065 (Jan. 8, 2015) (SR-OCC-2014-809).

access to liquid resources through a committed repurchase agreement, which would have the additional advantage of helping to maintain diversity among the liquidity resources that OCC may use to resolve a Clearing Member default.³¹ As such, the Commission believes that the proposal would promote robust risk management practices at OCC, consistent with Section 805(b) of the Clearing Supervision Act.³²

The Commission also believes that the changes proposed in the Advance Notice are consistent with promoting safety and soundness, reducing systemic risks, and promoting the stability of the broader financial system. As described above, the Bank Repo Facility would provide OCC with another liquidity resource in the event of a Clearing Member default, in addition to the existing syndicated credit facility and Clearing Member minimum cash Clearing Fund requirements. This would promote safety and soundness for Clearing Members because it would provide OCC with diversity among resources and a readily available liquidity resource that could enable OCC to continue to meet its settlement obligations in a timely fashion in the event of a Clearing Member default, thereby helping to contain losses and liquidity pressures from such a default. Maintaining adequate and diversified resources to help manage a Clearing Member default, in turn, enhances OCC's ability to manage systemic risk and to support the broader financial system. As such, the Commission believes it is consistent with promoting safety and soundness, reducing systemic risks, and promoting the stability of

³¹ OCC maintains access to a diverse set of funding sources in addition to the Bank and Non-Bank Repo Facilities, including a syndicated credit facility and Clearing Member minimum cash Clearing Fund requirements.

³² 12 U.S.C. 5464(b).

the broader financial system as contemplated in Section 805(b) of the Clearing Supervision Act.³³

Accordingly, and for the reasons stated above, the Commission believes the changes proposed in the Advance Notice are consistent with Section 805(b) of the Clearing Supervision Act.³⁴

B. Consistency with Rule 17Ad-22(e)(7) under the Exchange Act

Rule 17Ad-22(e)(7)(ii) under the Exchange Act requires that a covered clearing agency establish, implement, maintain, and enforce written policies and procedures reasonably designed to effectively measure, monitor, and manage the liquidity risk that arises in or is borne by the covered clearing agency, including measuring, monitoring, and managing its settlement and funding flows on an ongoing and timely basis, and its use of intraday liquidity by, at a minimum, holding qualifying liquid resources sufficient to meet the minimum liquidity resource requirement under Rule 17Ad-22(e)(7)(i)³⁵ in each relevant currency for which the covered clearing agency has payment obligations

³³ 12 U.S.C. 5464(b).

³⁴ 12 U.S.C. 5464(b).

³⁵ Rule 17Ad-22(e)(7)(i) requires OCC to establish, implement, maintain and enforce written policies and procedures reasonably designed to effectively measure, monitor, and manage liquidity risk that arises in or is borne by OCC, including measuring, monitoring, and managing its settlement and funding flows on an ongoing and timely basis, and its use of intraday liquidity by, at a minimum, maintaining sufficient liquid resources at the minimum in all relevant currencies to effect same-day settlement of payment obligations with a high degree of confidence under a wide range of foreseeable stress scenarios that includes, but is not limited to, the default of the participant family that would generate the largest aggregate payment of obligation for the covered clearing agency in extreme but plausible conditions. 17 CFR 240.17Ad-22(e)(7)(i).

owed to clearing members.³⁶ For any covered clearing agency, “qualifying liquid resources” means assets that are readily available and convertible into cash through prearranged funding arrangements, such as, committed arrangements without material adverse change provisions, including, among others, repurchase agreements.³⁷

As described above, implementation of the Bank Repo Facility would provide OCC with a committed funding arrangement that would give OCC access to \$500 million of committed liquid resources through an MRA with a bank counterparty. Under the terms of the MRA, OCC’s bank counterparty would be required to provide OCC with funding subject to a number of conditions, including an obligation to fund regardless of any material adverse change at OCC, such as the failure of a Clearing Member. Taken together, the Commission believes that the Bank Repo Facility provides OCC with \$500 million of “qualifying liquid resources” as that term is defined in Rule 17Ad-22(e)(14) of the Exchange Act,³⁸ and therefore is consistent with the requirements of Rule 17Ad-22(e)(7)(ii) under the Exchange.

Accordingly, the Commission believes that implementation of the Bank Repo Facility would be consistent with Rule 17Ad-22(e)(7)(ii) under the Exchange Act.³⁹

³⁶ 17 CFR 240.17Ad-22(e)(7)(ii).

³⁷ 17 CFR 240.17Ad-22(a)(14)(ii)(3).

³⁸ 17 CFR 240.17Ad-22(a)(14)(ii)(3).

³⁹ 17 CFR 240.17Ad-22(e)(7)(ii).

IV. CONCLUSION

IT IS THEREFORE NOTICED, pursuant to Section 806(e)(1)(I) of the Clearing Supervision Act, that the Commission DOES NOT OBJECT to Advance Notice (SR-OCC-2020-801) and that OCC is AUTHORIZED to implement the proposed change as of the date of this notice.

By the Commission.

Vanessa A. Countryman
Secretary