

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-86725; File No. SR-OCC-2019-007)

August 21, 2019

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of Proposed Rule Change Concerning a Proposed Capital Management Policy That Would Support The Options Clearing Corporation's Function as a Systemically Important Financial Market Utility

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on August 9, 2019, the Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("Commission" or "SEC) the proposed rule change as described in Items I, II, and III below, which Items have been prepared primarily by OCC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Clearing Agency's Statement of the Terms of Substance of the Proposed Rule Change

This proposed rule change by OCC would adopt a Capital Management Policy, which includes OCC's plan to replenish its capital in the event it falls close to or below its target capital (as defined below, "Replenishment Plan"). The Capital Management Policy is included in confidential Exhibit 5a of the filing.<sup>3</sup> In order to implement aspects of the new Capital Management Policy, the proposed rule change would also amend the following governing documents: OCC's Rules, which can be found in Exhibit 5b, and

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> The Commission notes that exhibits referenced herein are included in the filing submitted by OCC to the Commission, but are not included in this Notice.

OCC's schedule of fees, which can be found in Exhibit 5c. Material proposed to be added to OCC's Rules and schedule of fees, as currently in effect, is marked by underlining, and material proposed to be deleted is marked with strikethrough text. All terms with initial capitalization that are not otherwise defined herein have the same meaning as set forth in the OCC By-Laws and Rules.<sup>4</sup>

II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, OCC included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. OCC has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of these statements.

A. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

OCC is proposing to adopt a new Capital Management Policy and to make amendments to OCC's Rules and schedule of fees necessary to implement the new Capital Management Policy. The main features of the Capital Management Policy and the related changes are: (a) to determine the amount of Equity sufficient for OCC to meet its regulatory obligations and to serve market participants and the public interest (as

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<sup>4</sup> OCC's By-Laws and Rules can be found on OCC's public website: <http://optionsclearing.com/about/publications/bylaws.jsp>.

defined below, “Target Capital Requirement”), (b) to monitor Equity<sup>5</sup> and liquid net assets funded by equity (“LNAFBE”)<sup>6</sup> levels to help ensure adequate financial resources are available to meet general business obligations; and (c) to manage Equity levels, including by (i) adjusting OCC’s fee schedule (as appropriate) and (ii) establishing a plan for accessing additional capital should OCC’s Equity fall below certain thresholds (“Replenishment Plan”).

The Replenishment Plan would: (i) provide that should OCC’s Equity fall below 110% of the Target Capital Requirement (as defined by the Capital Management Policy, “Early Warning”), Management would recommend to the Board whether to implement a fee increase in an amount the Board determines necessary and appropriate to raise additional Equity; (ii) provide that should OCC’s Equity fall below 90% of the Target Capital Requirement or fall below the Target Capital Requirement for a period of 90 consecutive days (as defined in the Capital Management Policy, “Trigger Event”), OCC would contribute the funds held under The Options Clearing Corporation Executive Deferred Compensation Plan Trust to the extent that such funds are (x) deposited on or after January 1, 2020 in respect of its Executive Deferred Compensation Plan (“EDCP”) and (y) in excess of amounts necessary to pay for benefits accrued and vested under the EDCP at such time (such funds are defined in Chapter 1 of the proposed changes to OCC’s Rules as the “EDCP Unvested Balance”); and (iii) provide that should

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<sup>5</sup> The Capital Management Policy would define “Equity” as shareholders’ equity as shown on OCC’s Statement of Financial Condition.

<sup>6</sup> The Capital Management Policy would define “LNAFBE” as the level of cash and cash equivalents, no greater than Equity, less any approved adjustments (i.e., agency-related liabilities such as Section 31 fees held by OCC).

contribution of the EDCP Unvested Balance fail to cure the Trigger Event, or if a further Trigger Event occurs, OCC will charge an Operational Loss Fee (as defined below) in equal shares to the Clearing Members.

OCC is also hereby proposing to create a layer of skin-in-the-game resources in the event of default losses. Specifically, OCC is amending Rule 1006 to state that: first, any current or retained earnings above 110% of the Target Capital Requirement will be used to offset default losses after applying a defaulting Clearing Member's margin and Clearing Fund contributions, and next, any remaining loss will be charged pro rata to (a) non-defaulting Clearing Members' Clearing Fund contributions, and (b) the aggregate value of the EDCP Unvested Balance.

### **Proposed Changes**

OCC proposes to adopt a Capital Management Policy and make conforming changes to OCC's Rules and schedule of fees necessary to implement the Capital Management Policy, as described below, to formalize its policy to identify, monitor, and manage OCC's capital needs to promote compliance SEC Rule 17Ad-22(e)(15).<sup>7</sup> In formulating the Capital Management Policy, OCC also has considered the Commodity Futures Trading Commission's ("CFTC") regulatory capital requirements for OCC as a DCO, as set forth in CFTC Rule 39.11(a)(2).<sup>8</sup>

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<sup>7</sup> 17 CFR 240.17Ad-22(e)(15).

<sup>8</sup> 17 CFR 39.11(a)(2).

## Target Capital Requirement

The proposed Capital Management Policy would explain how OCC would annually determine the Target Capital Requirement. The proposed amendment to Chapter 1 of OCC's Rules would define OCC's Target Capital Requirement as the minimum level of Equity recommended by Management and approved by the Board to ensure compliance with applicable regulatory requirements and to keep such additional amount the Board may approve for capital expenditures. Resources held to meet OCC's Target Capital Requirement would be in addition to OCC's resources to cover participant defaults. OCC considers the LNAFBE it holds, limited to cash and cash equivalents, to be high quality and sufficiently liquid to allow OCC to meet its current and projected operating expenses under a range of scenarios, including in adverse market conditions. The Capital Management Policy would also explain that, on an annual basis, OCC's Chief Financial Officer ("CFO") would recommend a Target Capital Requirement for the coming year. Management would review the CFO's report and, as appropriate, recommend the Target Capital Requirement to the Compensation and Performance Committee ("CPC"). The CPC would review, and as appropriate, recommend the proposal to the Board of Directors, which would review, and as appropriate, approve the Target Capital Requirement.

### *SEC Rule 17Ad-22(e)(15)*

OCC would set its Target Capital Requirement at a level sufficient to maintain LNAFBE at least equal to the greatest of three amounts: (x) six-months' current operating expenses; (y) the amount determined by the Board to be sufficient to ensure a recovery or orderly wind-down of critical operations and services (the "RWD Amount");

and (z) the amount determined by the Board to be sufficient for OCC to continue operations and services as a going concern if general business losses materialize (the “Potential Loss Amount”).

The RWD Amount would be the amount recommended by Management on an annual basis in accordance with OCC’s Capital Management Procedure<sup>9</sup> and, as appropriate, approved by the Board. OCC’s Recovery and Orderly Wind-Down Plan (“RWD Plan”) identifies critical services and the length of time the Board has determined it would take to recover or wind-down.<sup>10</sup> Pursuant to the Capital Management Procedure, Management would use the assumptions in the RWD Plan to determine the RWD Amount, which is the cost to maintain those critical services over the prescribed recovery or wind-down period, assuming costs remain at historical levels. The calculation of the Potential Loss Amount would be based on Management’s annual determination, pursuant to the Capital Management Procedure, of the amount of capital required to address OCC’s operational risks. OCC quantifies the amount of capital to be held against OCC’s operational risks by analyzing and aggregating potential losses from individual

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<sup>9</sup> The Capital Management Procedure would be a cross-department internal procedure that provides direction on how those departments shall execute their responsibilities under the proposed Capital Management Policy. OCC has included a draft of the Capital Management Procedure OCC intends to implement if the Commission approves the proposed Capital Management Policy in confidential Exhibit 3a, for reference. The documents in Exhibit 3 are being provided as supplemental information to the filing and would not constitute part of OCC’s rules, which have been provided in Exhibit 5.

<sup>10</sup> Securities Exchange Act Release No. 83918 (Aug. 23, 2018), 83 FR 44091 (Aug. 29, 2018) (SR-OCC-2017-021).

operational risk scenarios, aggregating the loss events, and conducting loss modeling at or above the 99% confidence level.<sup>11</sup>

*CFTC Rule 39.11(a)(2)*

The Capital Management Policy would also specify that when setting the Target Capital Requirement the Board will consider OCC's projected rolling twelve-months' operating expenses as required by CFTC Rule 39.11(a)(2).<sup>12</sup> For the avoidance of doubt, the Board is not required to set the Target Capital Requirement at the level of twelve-months' operating expenses.<sup>13</sup> Factors that OCC would consider when considering twelve-months' operating expenses include, but are not limited to: (i) OCC's obligations and responsibilities as a systemically important financial utility ("SIFMU"), (ii) OCC's obligations as a derivative clearing organization under CFTC Rule 39.11(a)(2), (iii) the types of financial resources the CFTC allows OCC to count towards the twelve-month requirement, and (iv) any conditions on the use of those resources the CFTC has imposed.

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<sup>11</sup> Pursuant to the Capital Management Procedure, OCC's Enterprise Risk Management department ("ERM") would quantify the Potential Loss Amount on an annual basis and provide that information to OCC's Chief Financial Officer ("CFO") as an input to the CFO's recommendation to Management for the Target Capital Requirement. OCC has included ERM's process and methodology for quantifying the Potential Loss Amount from 2015 through present in confidential Exhibit 3b.

<sup>12</sup> 17 CFR 39.11(a)(2).

<sup>13</sup> Financial resources available to meet CFTC Rule 39.11(a)(2) are not limited to LNAFBE, and include OCC's own capital or any other form of financial resources deemed acceptable by the CFTC. See 17 CFR 39.11(b)(2).

### *Excess Equity for Capital Expenditures*

In addition, the Capital Management Policy would provide that OCC may increase its Target Capital Requirement by an amount to be retained for capital expenditures following a recommendation by Management and Board approval. From time to time Management may identify necessary capital investments in OCC's technology, facilities or other business tangible or intangible assets to enhance its effectiveness, efficiency or compliance posture. The Board would (a) determine if the capital needs are necessary and appropriate and, if so, (b) determine whether to increase the Target Capital Requirement or whether the amount can be accumulated as an amount in excess of the Target Capital Requirement. In case of the latter, capital in excess of 110% of the Target Capital Requirement would be available as skin in the game.<sup>14</sup> Factors the Board would consider in making this determination include, but are not limited to, the amount of funding required, how much Equity is proposed to be retained, the potential impact of the investment on OCC's operation, and the duration of time over which funds would be accumulated.

### Monitoring Equity

The proposed Capital Management Policy would describe how Management reviews periodic analyses of LNAFBE, including projecting future volume, expenses, cash flows, capital needs and other factors to help ensure adequate financial resources are available to meet general business obligations. Those other factors would include, but not be limited to: (i) the level of existing prefunded corporate resources, (ii) the ability to

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<sup>14</sup> See OCC Rule 1006(e), as proposed in the changes attached [sic; the Commission notes that "attached" here means that the SRO included the relevant document as a confidential exhibit to the filing] as Exhibit 5b hereto.



borrow under an existing OCC line of credit; (iii) the ability to make a claim under certain insurance policies; (iv) OCC's tax rates and liabilities; and (v) unfunded obligations. The Capital Management Policy would further provide that Management would review an analysis of Equity at least monthly to identify whether an Early Warning or Trigger Event had occurred since the last review or was likely to occur before the next review. The Capital Management Policy would provide that the Board of Directors is notified promptly if those triggers are breached. To the extent OCC suffers a catastrophic or sizable loss intra-month, and such loss amount is known or can reasonably be estimated, Management would review a forecast of the impact on Equity and, should that forecast demonstrate that Equity has fallen below the Early Warning or Trigger Event, Management shall promptly notify the Board.

#### Managing Equity

The Capital Management Policy would describe the actions OCC may take to manage its current or future levels of Equity. As described below, the primary forms of capital management actions would include: (i) changes to OCC's fees or other tools to change costs for market participants; (ii) the Replenishment Plan; and (iii) use of current and retained earnings greater than 100% of the Target Capital Requirement to cover losses caused by the default of a Clearing Member.

#### *Fee Schedule*

The Capital Management Policy would provide that clearing fees will be based on the sum of OCC's annual budgeted/forecasted operating expenses, a defined operating margin and OCC's capital needs, divided by forecasted contract sides. On an annual basis, Management would review the operating margin level considering historical

volume variance and other relevant factors, including but not limited to variance in interest rates and OCC's operating expenses. Management would recommend to the CPC, to which the Board has delegated authority for review and approval of changes to OCC's fees pursuant to the CPC's charter, whether changes to OCC's defined operating margin should be made.

The Capital Management Policy would provide that on a quarterly basis, Management would review its fee schedule and, considering factors including, but not limited to projected operating expenses, projected volumes, anticipated cash flows, and capital needs, recommend to the Board, or a Committee to which the Board delegated authority, whether a fee increase, decrease or waiver should be made in accordance with Article IX, Section 9 of OCC's By-Laws.<sup>15</sup>

The Capital Management Policy would provide that if OCC's Equity is above, in the aggregate, 110% of the Target Capital Requirement and any amount of excess Equity the Board approves for capital expenditures, the Board of Directors, or a Committee the Board has delegated, may use such tools as it considers appropriate to lower costs for Clearing Members, providing the Board believes doing so would likely not lower OCC's Equity below the Early Warning. Such tools would include lowering fees, a fee holiday or a refund. The Capital Management Policy would further provide that if OCC charges the Operational Loss Fee, as described below, and its Equity thereafter returns to a level at which the Board approves use of such tools, OCC would first employ tools to lower the cost of Clearing Member participation in equal share up to the amount of the

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<sup>15</sup> OCC By-Law Art. IX, § 9.

Operational Loss Fee charged. This provision would help ensure that in the event OCC must charge an Operational Loss Fee to Clearing Members in equal shares, Clearing Members will recover the amount charged in equal shares up to the amount charged.

#### *Replenishment Plan*

##### Early Warning

The Capital Management Policy would provide that in the event OCC's Equity breaches the Early Warning threshold, or 110% of the Target Capital Requirement, Management would recommend to the Board whether to implement a fee increase in an amount the Board determines necessary and appropriate to raise additional Equity.<sup>16</sup> The recommendation whether to implement a fee increase would be informed by several factors including, but not limited to, (i) the facts, circumstances and root cause of a decrease in Equity below the Early Warning threshold; (ii) the time it would take to implement a fee increase, inclusive of securing Board and SEC approval as required for those actions; (iii) the anticipated time a fee increase would take to accumulate the needed revenue based on projected contract volume, operational expenses and interest income over that time period; and (iv) the potential of a Trigger Event.

The Early Warning is intended to signal to OCC that its Equity is "close to" the Target Capital Requirement, as directed by Rule 17Ad22(e)(15)(iii). The Early Warning threshold is set at 110% because based on an analysis of OCC's projected revenue and

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<sup>16</sup> Pursuant to the Capital Management Procedure, Management's recommendation would be informed by the clearing fee amount calculated pursuant to the Fee Schedule Calculation Procedure, which provides direction to OCC's Finance department on how to calculate the necessary fee level pursuant to the requirements of the Capital Management Policy. OCC has included a draft of the Fee Schedule Calculation Procedure it intends to implement if the Commission approves the proposed Capital Management Policy in confidential Exhibit 3c, for reference.

expenses,<sup>17</sup> a 10% premium of the Target Capital Requirement represents approximately two months earnings based on current and projected data,<sup>18</sup> which OCC believes would provide sufficient time for Management and the Board to respond. The Capital Management Policy would provide that to the extent Management determines, during its annual review of the Capital Management Policy, that there is a change in the estimated length of time to accumulate approximately 10% of the Target Capital Requirement, Management will consider whether to recommend changes to the Early Warning and Trigger Event thresholds.

#### Trigger Event

The Capital Management Policy would also define a Trigger Event to be when OCC's Equity falls below 90% of the Target Capital Requirement or remains below the Target Capital Requirement for ninety consecutive calendar days. OCC is proposing the 90% threshold based on its analysis showing that two-months' earnings represents approximately a 10% percent premium of the Target Capital Requirement, discussed above. OCC believes, based on that analysis, that Equity below the 90% threshold would be a sign that corrective action more significant and with a more immediate impact than increasing fees should be taken to increase OCC's Equity Capital. OCC also set another Trigger Event at a threshold of Equity above 90% but below the Target Capital Requirement for a period of 90 consecutive days based on the time necessary for a

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<sup>17</sup> OCC has included the analysis in confidential Exhibit 3d.

<sup>18</sup> OCC defines earnings for purposes of this analysis as Operating Income, or revenue less expenses before taxes. Earnings does not include interest pass through earned on the cash deposits.

clearing fee change to have an impact and to exhaust remedies prior to charging the Operational Loss Fee. This timeframe takes into account 30-day advance notice to Clearing Members to implement the fee change, implementation on the first of the month to accommodate changes to Clearing Members' systems, and, as discussed above, the approximately two-month period required to accumulate approximately 10% of the Target Capital Requirement. Based on the above-referenced analysis, OCC believes that, in the event a fee increase resulting from an Early Warning could not increase OCC's Equity above the Target Capital Requirement within 90 days, it would likewise indicate that corrective action in the form of a fee increase would be insufficient.

If a Trigger Event occurs, OCC would first contribute the EDCP Unvested Balance to cure the loss. OCC believes that contributing the EDCP Unvested Balance to cover operational losses would align Management's interests with OCC's interest in maintaining required regulatory capital and operating OCC in a prudent manner. If application of the EDCP Unvested Balance brings OCC's Equity to within the Early Warning threshold (between 90% and 110% of the Target Capital Requirement), OCC would act to raise fees, in accordance with the Capital Management Policy's direction for OCC action in the event of an Early Warning, as discussed above.

If, however, OCC Equity remains below 90% of the Target Capital Requirement after applying the EDCP Unvested Balance, or if a subsequent Trigger Event occurs after applying all of the available EDCP Unvested Balance, OCC would charge an "Operational Loss Fee," up to the maximum Operational Loss Fee identified in OCC's schedule of fees as described below, in equal shares to each Clearing Member, payable on five business days' notice, to raise additional capital. A further Trigger Event based

on Equity falling below the Target Capital Requirement for a period of 90 consecutive calendar days would be measured beginning on the date OCC applies the EDCP Unvested Balance. OCC chose five business days to allow Clearing Members subject to the fee to assess its impact on their liquidity and take appropriate actions. OCC did not select a shorter period, such as the two-day period in which Clearing Members must fund Clearing Fund contributions,<sup>19</sup> because that shorter period is necessary for settlement obligations, which is not the case for the Operational Loss Fee.

OCC would calculate the maximum aggregate Operational Loss Fee based on the RWD Amount, which would ensure that OCC would have sufficient capital to facilitate a recovery or an orderly wind-down in the event of an operational loss. In order to account for OCC's tax liability for retaining the Operational Loss Fee as earnings, OCC may apply a tax gross-up to the RWD Amount ("Adjusted RWD Amount") depending on whether the operational loss that caused Equity to fall below the Trigger Event threshold is tax deductible. The Capital Management Policy would provide that, in the event less than the full amount of the maximum Operational Loss Fee is needed to bring OCC's Equity to 110% of the Target Capital Requirement, only that amount will be charged. If OCC charges less than the maximum Operational Loss Fee, any remaining amount up to the maximum Operational Loss Fee will remain available for subsequent Trigger Events, provided that the sum of all Operational Loss Fees that have not been refunded shall not exceed the maximum Operational Loss Fee.

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<sup>19</sup> See, e.g., OCC Rule 1006(h)(A).

In the event that OCC employs a refund to Clearing Members in equal shares up to the amount of Operational Loss Fees previously charged, the amount of the maximum Operational Loss Fee available for subsequent Trigger Events would include the amount refunded. By allowing OCC to charge up to the maximum Operational Loss Fee – less any amounts previously charged and not refunded – should subsequent Trigger Events arise, the proposed Capital Management Policy would help maintain the continued ability of OCC to access replenishment capital should multiple Trigger Events occur in quick succession before OCC could implement a new or modified replenishment plan. In the unlikely event that the sum of all Operational Loss Fees charged exhausts the maximum Operational Loss Fee, the Board would need to convene to develop a new replenishment plan, subject to regulatory approval.

In formulating the Capital Management Policy OCC considered other means of allocating the Operational Loss Fee among OCC's Clearing Members, including allocating the cost to Clearing Members proportionally based on measures such as contract volume or risk profile, as evidenced by a Clearing Member's margin or clearing fund contributions. As part of its analysis for determining the Potential Loss Amount, OCC has identified individual operational risk scenarios that could result in an operational loss, including such risks as internal fraud, a cyber-attack on OCC's systems, employee lawsuits and damage to its facilities. The operational risks OCC identified are separate and distinct from the credit risk that Clearing Members present to OCC, which OCC manages through margin and Clearing Fund contributions and OCC's Default Management Procedures. OCC has not observed any correlation between the annual quantification of these risks and contract volume or Clearing Member credit risk. OCC

has included a comparison of its quantification of these risks to contract volume and the amount of Clearing Fund deposits in confidential Exhibit 3e. OCC believes that charging the Operational Loss Fee in equal shares is preferable because it equally mutualizes risk of operational loss amongst the firms that use OCC's services. OCC believes that such mutualization is preferable because all Clearing Members benefit from equal access to the clearance and settlement services provided by OCC, irrespective of how much they choose to use it. Such access provides the benefit of credit and liquidity risk intermediation and associated regulatory capital benefits.

To implement the Operational Loss Fee, OCC is proposing an amendment to its schedule of fees that would provide a formula for calculating the maximum Operational Loss Fee OCC could charge, attached [sic] to this rule filing as Exhibit 5c. The amendment to OCC's fee schedule would express the Operational Loss Fee as a fraction, the numerator of which would be the Adjusted RWD Amount less the aggregate amount of Operational Loss Fees that OCC has previously charged that are not refunded at the time of calculation, and the denominator of which would be the number of Clearing Members at the time OCC charges the Operational Loss Fee. OCC would also include in the schedule of fees the conditions that would trigger the Operational Loss Fee to be charged. OCC proposes to amend its schedule of fees now: (1) to increase transparency about Clearing Members' maximum contingent obligations under the Capital Management Policy in the unlikely event OCC's Equity falls below the Trigger Event thresholds, (2) to promote operational efficiency so that OCC can access replenishment capital expeditiously if a Trigger Event occurs, and (3) to reduce the likelihood that OCC would be required to file an advance notice or proposed rule change prior to charging the



Operational Loss Fee, thereby accelerating the time frame in which OCC could access replenishment capital if losses materialize that threaten OCC's ability to continue operations and services as a going concern.

To effectuate the Capital Management Policy, OCC also proposes to amend OCC Rule 209 so that the Operational Loss Fee would be payable within five business days. OCC Rule 209 currently provides that all charges and fees owed by a Clearing Member to OCC shall be due and payable within five business days following the end of each calendar month. The proposed amendment would add an exception for payment of the Operational Loss Fee, which would be due and payable within five business days following OCC's notice to the Clearing Member that OCC had charged the Operational Loss Fee. The amendment to OCC Rule 209 would ensure that OCC can timely respond to operational losses that threaten OCC's ability to continue operations and services as a going concern. OCC would also amend Rule 101 to define "Operational Loss Fee" to mean the fee that would be charged to Clearing Members in equal shares, up to the maximum amount identified in OCC's schedule of fees less the aggregate amount of all such Operational Loss Fees previously charged and not yet refunded at the time of calculation, if, after contributing the entire EDCP Unvested Balance, Equity remains below the levels identified in OCC's schedule of fees.

*Use of Current and Retained Earnings for Default Losses*

The Capital Management Policy would provide that in the event of a clearing member default, OCC would use Equity above 110% of the Target Capital Requirement to offset any loss after applying the margin assets and Clearing Fund contribution of the defaulting Clearing Member. In addition, the Capital Management Policy would provide

that OCC would contribute the EDCP Unvested Balance on a pro rata basis with non-defaulting Clearing Member contributions to the Clearing Fund to satisfy any remaining balance after applying the margin assets and Clearing Fund contribution of the defaulting Clearing Member and any OCC Equity above 110% of the Target Capital Requirement.

To implement this aspect of the Capital Management Policy, OCC would also amend OCC Rule 1006 to adjust the default waterfall and the allocation of Clearing Fund losses accordingly. Rule 1006(e), which currently governs use of retained earnings to cover certain losses prior to charging those losses to the Clearing Fund under Rule 1006(b) (i.e., losses caused by Clearing Member defaults) and Rule 1006(c) (i.e., losses caused by bank and clearing organization failures to perform obligations to OCC not recoverable under Rule 1006(b)), would be divided into subsections numbered Rule 1006(e)(i) through (e)(iii). OCC would add Rule 1006(e)(i) to require OCC to charge a loss or deficiency associated with a Clearing Member default to OCC's current and retained earnings that are greater than 110% of its Target Capital Requirement (which would be defined as above in Rule 101) prior to charging the Clearing Fund and the EDCP Unvested Balance under Rule 1006(b), as discussed below. Rule 1006(e)(ii) would contain the current text of the first two sentences of the current Rule 1006(e), updating the cross-reference therein to limit the scope to the use of earnings to cover losses caused by bank or clearing organization failures before charging the Clearing Fund under Rule 1006(c). Thus, OCC would retain the option, but not the obligation, to use current or retained earnings to cover such bank or clearing organization losses, for which the Rules currently provide. Rule 1006(e)(iii) would contain the last two sentences of Rule 1006(e) currently in effect, which concern (1) the meaning of "current earnings" and

(2) provide for a Clearing Member's continuing liability for any deficiencies in that member's Clearing Fund contribution that OCC covers with OCC's current and retained earnings. With respect to the latter, OCC would amend Rule 1006(e)(iii) to remove reference to OCC's "elect[ion]" to charge the deficiency to current or retained earnings so that such liability for Clearing Fund contribution deficiencies remains if OCC is obligated to charge current and retained earnings over 110% of the Target Capital Requirement under proposed Rule 1006(e)(i).

OCC also proposes to amend Rule 1006(b) to provide that OCC would apply the EDCP Unvested Balance (which would be defined as above in Rule 101) on a pro rata basis with the Clearing Fund contributions of non-defaulting Clearing Members to satisfy any remaining balance after applying the defaulting Clearing Member's margin and Clearing Fund contribution and OCC's current and retained earnings greater than 110% of its Target Capital Requirement. By amendment to Rule 1006(b)(iii), the EDCP Unvested Balance's proportion of the loss would be calculated by a fraction, the numerator of which would be EDCP Unvested Balance and the denominator of which would be the sum of the EDCP Unvested Balance and the balance of all non-defaulting Clearing Members' Clearing Fund contributions.<sup>20</sup> Pursuant to proposed amendments to

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<sup>20</sup> Because Rule 1006 has separate provisions addressing use of the Clearing Fund to cover losses arising from a Clearing Member default (Rule 1006(b)) and losses arising from bank or clearing organization failures (Rule 1006(c)), certain changes would be made to the rules to limit the changes for purposes of effecting the Capital Management Policy to the use of current and retained earnings and the EDCP Unvested Balance in the event of a Clearing Member default. Specifically, the proposed changes to OCC's rules would eliminate Interpretations and Policies .01 and establishes the respective allocation provisions in Rule 1006(b)(iii) and (c)(iii). No substantive changes to Rule 1006(c) are intended.

Rule 1006(b) and (e), such contribution of current and retained earnings would be made after applying the defaulting Clearing Member's margin and Clearing Fund contribution, but before charging that loss or deficiency proportionately to the Clearing Fund.

In addition, a proposed amendment to Rule 1006(g), concerning, among other things, the allocation of funds received under the Limited Cross-Guaranty Agreement between OCC and certain other clearing agencies in the event of the default of a common member, would provide that any funds received under that agreement by OCC with respect to losses incurred by OCC would be credited in accordance with Rule 1010. Rule 1010 concerns recovery of losses charged to non-defaulting Clearing Members and provides that any recovery of a loss charged proportionately against the contributions of those Clearing Members shall be paid to each Clearing Member charged in proportion to the amounts charged. The amendment to Rule 1006(g) would establish that the non-defaulting Clearing Members whose Clearing Fund contributions were charged would recover proportional to the amount their contributions were charged up to the amount their Clearing Fund contributions were charged. The recovery proportional to the amount charged to the EDCP Unvested Balance would be available for return to the EDCP.

#### *Market Participant Outreach*

In developing the proposed plan for replenishment capital OCC also sought input from market participants. On May 1, 2019, OCC Management presented to the SIFMA options committee and the Securities Traders Association on the following topics: (1) how OCC will set fees, (2) how OCC determines its operating margin, (3) OCC's proposal to add a working capital line of credit, (4) the triggers and thresholds for action, and (5) the amount that a replenishment plan would need to raise. A discussion ensued

with participants from the SIFMA options committee concerning how OCC would set the Target Capital Requirement.

On May 28, 2019, OCC provided Clearing Members with a notice concerning the details of the Capital Management Policy.<sup>21</sup> OCC has included a copy of the letter in Exhibit 3f. OCC sent the same letter to the participant exchanges (including the non-shareholder exchanges). Either calls or meetings were held with non-shareholder exchanges to discuss the proposed Capital Management Policy and allow them to raise questions or concerns. No such concerns were expressed.

OCC conducted calls open to all Clearing Members on May 31, 2019 to discuss the proposal. The calls were attended by approximately 140 participants representing 40 organizations. No concerns with the proposed Capital Management Policy were expressed. Discussion ensued about the mechanics of the Operational Loss Fee, alternatives to equal allocation of the Operational Loss Fee among Clearing Members that OCC considered and the likelihood that OCC would need to charge the Operational Loss Fee. Management has also met with individual Clearing Members and other market participants to discuss the proposed Capital Management Policy.

After the Board meeting on July 17, 2019, OCC conducted a call with the SIFMA options committee to discuss certain features of the Capital Management Policy proposal approved at that meeting, including: (a) if OCC charges the Operational Loss Fee and its

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<sup>21</sup> The letter references a “one-time” Operational Loss Fee, consistent with the proposed Capital Management Policy as approved by the Board at its May 13, 2019 meeting. As discussed below, the Board approved a revision to the proposal at its July 17, 2019 meeting to allow OCC to retain the ability to charge the Operational Loss Fee for subsequent Trigger Events up to the maximum Operational Loss Fee, less any Operational Loss Fees previously charged and not yet refunded.

Equity thereafter returns to a level at which the Board approves use of tools to lower the cost of participation for Clearing Members, OCC would first employ tools to lower the Clearing Members' costs in equal share up to the amount of the Operational Loss Fee charged; and (b) if OCC charges the Operational Loss Fee, OCC would retain the ability to charge Operational Loss Fees for subsequent Trigger Events up to the maximum Operational Loss Fee, less any Operational Loss Fees previously charged and not yet refunded.

OCC has included a summary of the questions raised and Management's responses during the above referenced calls and meetings in Exhibit 3g.

## 2. Statutory Basis

OCC believes the proposed rule change is consistent with Section 17A of the Securities Exchange Act of 1934 ("Exchange Act") and the rules and regulations thereunder. In particular, OCC believes that the Capital Management Policy is consistent with Section 17A(b)(3)(F) of the Exchange Act<sup>22</sup> and Rule 17Ad-22(e)(15)<sup>23</sup> thereunder for the reasons described below. In addition, OCC believes adding the Operational Loss Fee to its schedule of fees is consistent with Section 17A(b)(3)(D) of the Exchange Act,<sup>24</sup> and that the changes to OCC's Rules to effectuate the use of current and retained earnings

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<sup>22</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>23</sup> 17 CFR 240.17Ad-22(e)(15).

<sup>24</sup> 15 U.S.C. 78q-1(b)(3)(D).

in excess of 110% of the Target Capital Requirement and the EDCP Unvested Balance to cover default losses is consistent with Rule 17Ad-22(e)(4).<sup>25</sup>

Section 17A(b)(3)(F) of the Exchange Act requires, in part, that the rules of OCC be designed to promote the prompt and accurate clearance and settlement of securities transactions and, in general, to protect investors and the public interest. The Capital Management Policy is designed to ensure that OCC holds sufficient LNAFBE such that it could continue to promptly and accurately clear and settle securities transactions even if it suffered significant operational losses. In other words, holding sufficient LNAFBE would help OCC to absorb such operational losses and avoid a disruption that could negatively impact OCC's prompt and accurate clearing and settlement of transactions. By limiting the financial resources OCC counts toward its LNAFBE to cash and cash equivalents, the Capital Management Policy ensures those resources would be high quality and sufficiently liquid to allow OCC to meet its current and projected operating expenses under a range of scenarios, including in adverse market conditions. OCC would protect the interests of investors and the general public by establishing the Capital Management Policy, which is designed to ensure that such losses would not result in a failure or disruption of a SIFMU, as OCC is designated by the Financial Stability Oversight Council ("FSOC") pursuant to the Payment, Clearing and Settlement Supervision Act.<sup>26</sup> FSOC has concluded that a failure or disruption at OCC would negatively affect significant dollar value and volume transactions in the options and futures markets, impose material losses on OCC counterparties and create liquidity and

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<sup>25</sup> 17 CFR 240.17Ad-22(e)(4).

<sup>26</sup> 12 U.S.C. 5463.

credit problems for financial institutions and others that rely on the markets OCC serves, and that such credit and liquidity problems would spread quickly and broadly among financial institutions and other markets.<sup>27</sup> Accordingly, FSOC determined that a failure or disruption at OCC could threaten the stability of the U.S. financial system.<sup>28</sup>

Therefore, OCC believes that the Capital Management Policy, which is reasonably designed to ensure that OCC has sufficient LNAFBE to continue operations in the event of an operational loss, is consistent with the requirements of Section 17A(b)(3)(F) of the Exchange Act by protecting investors and the public interest.<sup>29</sup>

Rule 17Ad-22(e)(15) under the Exchange Act requires OCC to establish, implement, maintain and enforce written policies and procedures reasonably designed to identify, monitor and manage OCC's general business risk and hold sufficient LNAFBE to cover potential general business losses so that OCC can continue operations and services as a going concern if those losses materialize.<sup>30</sup> The Capital Management Policy and amendments to OCC's Rules and Fee Schedule are designed for consistency with the requirements of Rule 17Ad-22(e)(15) for the reasons described below.

Rule 17Ad-22(e)(15)(i) requires, in part, that OCC establish, implement, maintain and enforce written policies and procedures reasonably designed to identify, monitor, and

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<sup>27</sup> FSOC Annual Report, Appendix A, at 187 (2012), available at <https://www.treasury.gov/initiatives/fsoc/Documents/2012%20Appendix%20A%20Designation%20of%20Systemically%20Important%20Market%20Utilities.pdf>

<sup>28</sup> Id.

<sup>29</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>30</sup> 17 CFR 240.17Ad-22(e)(15).



manage OCC's general business risk, including by determining the amount of LNAFBE based upon OCC's general business risk profile and the length of time required to achieve recovery or orderly wind-down, as appropriate, of its critical operations and services if such action is taken.<sup>31</sup> Pursuant to the Capital Management Policy, OCC would set its Target Capital Requirement at a level sufficient to maintain LNAFBE at least equal to the greater of (x) six months' of OCC's current operating expenses; (y) the amount determined by the Board to be sufficient to ensure a recovery or orderly wind-down of critical operations and services, plus any excess Equity Management recommends, and the Board approves, to be retained for capital expenditures; and (z) the amount determined by the Board to be sufficient for OCC to continue operations and services as a going concern if general business losses materialize. By providing that OCC would set its Target Capital Requirement no less than the greatest of these three amounts, OCC believes the Capital Management Policy is consistent with Rule 17Ad-22(e)(15)(i).

The Capital Management Policy is also designed to identify, monitor and manage OCC's general business risk, consistent with Rule 17Ad-22(e)(15), by providing that OCC's Board would review and approve the Target Capital Requirement annually. The Capital Management Policy is also designed to monitor OCC's general business risk by providing that OCC would perform an analysis of its Equity on at least a monthly basis to ensure that OCC's Equity has not fallen below the Early Warning or Trigger Event thresholds and is not likely to fall below those thresholds prior to the next review. The Capital Management Policy's requirement that Management report on the firm's

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<sup>31</sup> 17 CFR 240.17Ad-22(e)(15)(i).

LNAFBE relative to the Early Warning and Trigger Event thresholds at each regularly scheduled Board meeting is also designed to identify, monitor, and manage OCC's general business risk. The Capital Management Policy's requirement that the Board be promptly notified in the event of an Early Warning or Trigger Event is also reasonably designed to ensure that OCC can act quickly to ensure OCC's compliance with the LNAFBE-holding requirements of Rule 17Ad-22(e)(15).

Rule 17Ad-22(e)(15) further requires, in part, that OCC establish, implement, maintain and enforce written policies and procedures reasonably designed to hold sufficient LNAFBE to cover potential general business losses so that OCC can continue operations and services as a going concern if those losses materialize, including by holding LNAFBE equal to the greater of either (x) six months of OCC's current operating expenses, or (y) the amount determined by the Board to be sufficient to ensure a recovery or orderly wind-down of critical operations and services.<sup>32</sup> As described above, the Capital Management Policy would provide that OCC sets its Target Capital Requirement at a level sufficient to maintain LNAFBE in an amount that is the greatest of three amounts, which include six months' operating expenses, an amount determined by the Board to be sufficient to ensure recovery or orderly wind-down, and an amount determined by the Board to be sufficient for OCC to continue operations and services as a going concern if general business losses materialize. Therefore, the Capital Management Policy is designed to ensure that OCC maintains, at a minimum, LNAFBE equal to the greater of the two amounts required by Rule 17Ad-22(e)(15)(ii). By also including an

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<sup>32</sup> 17 CFR 240.17Ad-22(e)(15)(ii).

amount determined by the Board to be sufficient to meet general business losses should they materialize, the Capital Management Policy is designed to ensure OCC maintains LNAFBE at an amount necessary to satisfy Rule 17Ad-22(e)(15)'s broader requirement that OCC hold sufficient LNAFBE to cover potential general business losses so that OCC can continue operations and services as a going concern if those losses materialize.

Rule 17Ad-22(e)(15)(ii) further requires, in part, that LNAFBE held by OCC pursuant to Rule 17Ad-22(e)(15)(ii) shall be (A) in addition to resources held to cover participant defaults or other credit or liquidity risks,<sup>33</sup> and (B) of high quality and sufficiently liquid to allow OCC to meet its current and projected operating expenses under a range of scenarios, including in adverse market conditions.<sup>34</sup> The Capital Management Policy is designed to satisfy Rule 17Ad-22(e)(15)(ii)(A) by providing that the resources held to meet OCC's Target Capital Requirement are in addition to OCC's resources to cover participant defaults and liquidity shortfalls. While the Capital Management Policy and proposed changes to OCC's Rules provide for the use of capital to cover credit losses in the event of a Clearing Member default, the proposed changes limit the amount of current and retained earnings available to cover such losses to the amount above 110% of the Target Capital Requirement. The Capital Management Policy is also designed to satisfy Rule 17Ad-22(e)(15)(ii)(B) by providing that the resources held to meet OCC's Target Capital Requirement be high quality and sufficiently liquid.

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<sup>33</sup> 17 CFR 240.17Ad-22(e)(15)(ii)(A).

<sup>34</sup> 17 CFR 240.17Ad-22(e)(15)(ii)(B).

As a result, OCC believes the Capital Management Policy is designed to comply with Rule 17Ad-22(e)(15)(ii)(A) and (B).

Rule 17Ad-22(e)(15)(iii) requires that OCC establish, implement, maintain and enforce written policies and procedures reasonably designed to identify, monitor, and manage OCC's general business risk, including by maintaining a viable plan, approved by the Board and updated at least annually, for raising additional equity should its equity fall close to or below the amount required under Rule 17Ad-22(e)(15)(ii). The Capital Management Policy and amendments to OCC's Rules and schedule of fees are reasonably designed to establish a viable plan to raise additional capital in an amount up to the amount the Board determines annually to be sufficient to ensure recovery or orderly wind-down should OCC's Equity fall close to or below its Target Capital Requirement. By setting the threshold triggers by reference to the Target Capital Requirement, OCC's plan for replenishment capital is designed to require OCC to act to raise capital should its LNAFBE fall close to or below the amounts required under Rule 17Ad-22(e)(15)(ii). In addition, by providing that the Target Capital Requirement must be the greater of those amounts or the amount determined by the Board to be sufficient to cover potential general business losses so that OCC can continue operations and services as a going concern if those losses materialize, the Capital Management Policy is also reasonably designed to ensure that OCC has a viable plan to raise the capital necessary to comply with Rule 17Ad-22(e)(15) as a whole. Furthermore, the Capital Management Policy provides that Management shall on an annual basis recommend the Board approve or, as appropriate, modify the Replenishment Plan. The Board would review and, as appropriate, approve Management's recommendation. Should OCC charge the full

amount of the Operational Loss Fee, Management would recommend a new or modified replenishment plan, subject to regulatory approval. The Board would review and, as appropriate, approve Management's recommendation.

OCC's proposed addition of an Operational Loss Fee as part of its Replenishment Plan is also reasonably designed to establish a viable plan to raise additional capital. OCC's By-Laws and Rules serve as a contract between OCC and its Clearing Members. Thus, OCC believes the Operational Loss Fee is no less reliable than any other potential replenishment plan that does not involve accumulating replenishment capital in advance of any operational loss. Failure of a Clearing Member to pay the Operational Loss Fee if charged will have the same impact as failure to meet a margin call or clearing fund assessment, and thus may have significant consequences. Any Clearing Member in default of its obligations to OCC is subject to suspension and liquidation of the defaulting member's positions, from which OCC may collect all unpaid obligations to OCC.<sup>35</sup> Should the assets of the defaulting member be insufficient to cover its obligations, OCC may recover the unpaid amount from the Clearing Fund.<sup>36</sup>

While Rule 17Ad-22(e)(15)(iii) does not by its terms specify the amount of additional equity a clearing agency's plan for replenishment capital must be designed to raise, the SEC's adopting release states that "a viable plan generally should enable the covered clearing agency to hold sufficient liquid net assets to achieve recovery or orderly

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<sup>35</sup> OCC Rule 1108.

<sup>36</sup> OCC Rule 1006(a), clause (vi) (failure of any Clearing Member to make any other required payment or render any other required performance).

wind-down.”<sup>37</sup> OCC believes that the Capital Management Policy and Operational Loss Fee is consistent with the SEC’s adopting release for Rule 17Ad-22(e)(15)(iii) because OCC sets the maximum Operational Loss Fee at an amount sufficient to raise, on a post-tax basis, the amount determined annually by the Board to be sufficient to ensure recovery or orderly wind-down pursuant to the Board’s annual approval of the RWD Plan.

In its adopting release, the SEC also states that in developing its policies and procedures, a covered clearing agency “generally should consider and account for circumstances that may require a certain length of time before any plan can be implemented.”<sup>38</sup> In the case of an Early Warning, a fee increase would require Board approval, which could be obtained in a special meeting of the Board on an expedited basis. OCC would file the fee increase with the SEC for immediate effectiveness, thereby minimizing the amount of time needed to implement the new fee. In the case of a Trigger Event, the Operational Loss Fee added to the fee schedule would not require further Board approval to implement, and would likely not require further regulatory approval to implement because this proposed rule change would add the fee to OCC’s schedule of fees. By allowing OCC to charge up to the maximum Operational Loss Fee, less any Operational Loss Fees previously charged and not yet refunded, the Capital Management Policy would help OCC maintain its ability to access replenishment capital during the time it would take to implement a new or revised Replenishment Plan. The

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<sup>37</sup> Standards for Covered Clearing Agencies, Exchange Act Release No. 78961 (Sept. 28, 2016), 81 FR 70786, 70836 (Oct. 13, 2016).

<sup>38</sup> Id.

Operational Loss Fee and amendment to Rule 209(a) further account for the length of time to implement OCC's plan for replenishment capital by requiring payment within five business days. Therefore, OCC believes the proposed Capital Management Policy, Operational Loss Fee, and amendments to OCC's Rules are consistent with the SEC's adopting release for Rule 17Ad-22(e)(15)(iii).

OCC also believes the Operational Loss Fee is consistent with Section 17A(b)(3)(D) of the Exchange Act, which requires that the rules of a clearing agency provide for the equitable allocation of reasonable dues, fees and other charges among its participants. OCC believes the proposed Operational Loss Fee is reasonable because it is designed to accumulate additional capital to ensure that OCC can continue to meet its obligations as a SIFMU to Clearing Members and the general public. OCC believes that the proposed Operational Loss Fee is reasonable also because it is designed as a viable plan for replenishing OCC's LNAFBE in the event OCC's Equity falls below certain thresholds that are themselves designed to ensure that OCC act to raise additional capital before OCC's Equity reaches the amounts required by Rule 17Ad-22(e)(15)(ii). And as discussed above, by providing that the Replenishment Amount be sufficient to ensure OCC has sufficient capital to cover the amount the Board determines sufficient to ensure a recovery or orderly wind-down, OCC believes the Operational Loss Fee is consistent with Rule 17Ad-22(e)(15)(iii). OCC also believes that the proposed Operational Loss Fee would result in an equitable allocation of fees among its participants because it would equally mutualize risk of operational loss amongst the firms that use OCC's services. The Clearing Members' equal access to the clearance and settlement services provided by OCC, which provide the benefit of credit and liquidity risk intermediation and associated

regulatory capital benefits, is of equal benefit to all Clearing Members irrespective of how much they choose to use it. In addition, the Capital Management Policy provides that if OCC charges the Operational Loss Fee and its Equity thereafter returns to a level at which the Board approves use of tools to lower the cost of Clearing Member participation to return Equity in excess of 110% of its Target Capital Requirement, such as a refund, OCC will employ such tools to lower costs for Clearing Members in equal shares, up to the amount of the Operational Loss Fee charged. Thus, Clearing Members will share both the cost and recovery of the Operational Loss Fee equally. As a result, OCC believes that the proposed Operational Loss Fee provides for the equitable allocation of reasonable fees in accordance with Section 17A(b)(3)(D) of the Exchange Act.<sup>39</sup>

OCC also believes the amendments to its Rules for use of current and retained earnings and the EDCP Unvested Balance to cover default losses are consistent with Rule 17Ad-22(e)(4), which provides, in part, that OCC establish, implement, maintain and enforce written policies and procedures reasonably designed to effectively identify, measure, monitor and manage its credit exposures to participants and those arising from its payment, clearing and settlement processes, including by maintaining sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence.<sup>40</sup> By providing that OCC shall use current and retained earnings in excess of 110% of its Target Capital Requirement, as well as contributing the EDCP

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<sup>39</sup> 15 U.S.C. 78q-1(b)(3)(D).

<sup>40</sup> 17 CFR 240.17Ad-22(e)(4)(i).



Unvested Balance on a pro rata basis with Clearing Member's Clearing Fund contributions, OCC is providing for additional financial resources available to cover losses in the event of a Clearing Member default, and reducing the amount OCC would charge the Clearing Fund contributions of non-defaulting Clearing Members. Therefore, OCC believes the amendments to its Rules are consistent with Rule 17Ad-22(e)(4).

**B. Clearing Agency's Statement on Burden on Competition**

Section 17A(b)(3)(I) of the Exchange Act<sup>41</sup> requires that the rules of a clearing agency not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. OCC believes that the Capital Management Policy and amendments to OCC's Rules and schedule of fees would not have any impact, or impose any burden, on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act. As discussed above, the Capital Management Policy describes how OCC would measure, monitor and manage its capital needs to ensure appropriate financial resiliency for a SIFMU and comply with applicable financial regulations, including requirements about the amount of LNAFBE it must hold. The Capital Management Policy is designed for OCC to maintain Equity at a level necessary to meet the requirements of Rule 17Ad-22(e)(15) and serve its Clearing Members and the public interest.

While the proposed Operational Loss Fee, in the unlikely event it is charged, would have an effect on the amount of fees that Clearing Members pay for OCC's services, the proposed rule change is designed to allocate those fees on an equal basis to all Clearing Members. OCC's Rules currently require Clearing Members to maintain net

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<sup>41</sup> 15 U.S.C. 78q-1(b)(3)(I).

capital of at least \$2 million.<sup>42</sup> Based on the most recent financial information reported by Clearing Members, which OCC has included in confidential Exhibit 3h, OCC believes that 98% of Clearing Members could absorb the maximum amount of the Operational Loss Fee without breaching their minimum net capital requirements or the SEC’s “early warning” threshold.<sup>43</sup> OCC is comfortable with Clearing Members’ ability to pay the Operational Loss Fee because the amount of the maximum Operational Loss Fee that would be charged per Clearing Member is approximately the same as the contingent obligations under the OCC clearing fund assessment requirements for a Clearing Member operating at the minimum clearing fund deposit—\$1 million. Consequently, OCC does not believe the Operational Loss Fee obligation poses a significant barrier to entry for smaller Clearing Members. By adding the Operational Loss Fee to OCC’s schedule of fees, the fee would be a transparent obligation of membership based upon which Clearing Members can independently assess their rights and obligations.

In addition, the Capital Management Policy would help address the relative impact that charging the Operational Loss Fee in equal shares would have on smaller Clearing Members by providing that should OCC charge the fee and thereafter return to a position where the Board may approve tools to lower costs for Clearing Members, such as refunds, OCC would employ such tools to lower costs for Clearing Members on an equal basis, up to the amount of the Operational Loss Fee charged. Thus, all Clearing

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<sup>42</sup> OCC Rule 302.

<sup>43</sup> 17 CFR 240.15c3-1.

Members shall share equally in the cost and recovery of the Operational Loss Fee amounts charged.

Moreover, any barrier to entry that the Operational Loss Fee may impose is not unnecessary in furtherance of the Exchange Act, and the rules the SEC has promulgated thereunder. Pursuant to those rules, OCC must hold minimum LNAFBE and have a viable plan to replenish equity should OCC's equity fall close to or below those minimums. It is entirely appropriate that the Clearing Members that benefit equally from OCC's services share the burden equally should OCC experience an operational loss that threatens its ability to continue providing those services and comply with its regulatory obligations.

C. **Clearing Agency's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others**

Written comments were not and are not intended to be solicited with respect to the proposed rule change, and none have been received.

III. **Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action**

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- (A) by order approve or disapprove the proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change should be disapproved.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Exchange Act. Comments may be submitted by any of the following methods:

##### Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-OCC-2019-007 on the subject line.

##### Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-OCC-2019-007. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m.

and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of OCC and on OCC's website at

<https://www.theocc.com/about/publications/bylaws.jsp>.

All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly.

All submissions should refer to File Number SR-OCC-2019-007 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>44</sup>

Jill M. Peterson  
Assistant Secretary

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<sup>44</sup> 17 CFR 200.30-3(a)(12).