

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-91199; File No. SR-OCC-2021-003)

February 24, 2021

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of Proposed Rule Change to Establish OCC's Persistent Minimum Skin-In-The-Game

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act" or "Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on February 10, 2021, the Options Clearing Corporation ("OCC" or "Corporation") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared 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

The proposed rule change would amend OCC's Rules, Capital Management Policy, and certain other OCC policies to establish a persistent minimum level of OCC's own pre-funded financial resources (commonly referred to as "skin-in-the-game") that OCC would contribute to cover default losses or liquidity shortfalls. Amendments to OCC's Rules are included in Exhibit 5a of filing SR-OCC-2021-003. Amendments to OCC's Capital Management Policy are included in confidential Exhibit 5b of filing SR-OCC-2021-003. OCC would also make conforming changes to the Default Management Policy, Clearing Fund Methodology Policy, and Recovery and Orderly Wind-Down Plan ("RWD Plan"), which can be found in confidential Exhibits 5c, 5d, and 5e of filing SR-

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

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

OCC-2021-003, respectively, to reflect the amended default waterfall (i.e., the financial resources OCC would use to address default losses and liquidity shortfalls, listed in the order OCC would utilize them). Material proposed to be added 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>3</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 amend OCC's Rules, Capital Management Policy, and certain other policies to establish a persistent minimum level of skin-in-the-game that OCC would contribute to cover default losses or liquidity shortfalls, which would consist of a minimum amount of OCC's own pre-funded resources that OCC would charge prior to charging a loss to the Clearing Fund (as defined below, the "Minimum Corporate Contribution") and, as OCC's Rules currently provide, applicable funds held in trust in

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<sup>3</sup> OCC's By-Laws and Rules can be found on OCC's public website: <https://www.theocc.com/Company-Information/Documents-and-Archives/By-Laws-and-Rules>.

respect to OCC's Executive Deferred Compensation Plan ("EDCP") (such funds, as defined in OCC's Rules, being the "EDCP Unvested Balance") that would be charged pari passu with the Clearing Fund deposits of non-defaulting Clearing Members. The persistent minimum level of skin-in-the-game would establish a floor for the pre-funded resources OCC would contribute to cover default losses and liquidity shortfalls. In addition to this minimum, OCC would continue to commit its liquid net assets funded by equity ("LNAFBE")<sup>4</sup> greater than 110% of its Target Capital Requirement prior to charging a loss to the Clearing Fund.

## **Background**

In January 2020, OCC implemented its Capital Management Policy, by which OCC (a) determines the amount of Equity<sup>5</sup> sufficient for OCC to meet its regulatory obligations and to serve market participants and the public interest (as defined in OCC's Rules, the "Target Capital Requirement"), (b) monitors Equity and LNAFBE levels to help ensure adequate financial resources are available to meet general business obligations; and (c) manages Equity levels, including by (i) adjusting OCC's fee schedule (as appropriate) and (ii) establishing a plan for accessing additional capital should OCC's

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<sup>4</sup> International standards and the Commission's Rules established minimum LNAFBE requirements for financial market infrastructures and covered clearing agencies, respectively. See CPSS-IOSCO, Principles for financial market infrastructures, at Principle 15 (Apr. 16, 2012), available at <http://www.bis.org/publ/cpss101a.pdf>; 17 CFR 240.17Ad-22(e)(15). The Capital Management Policy defines "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).

<sup>5</sup> The Capital Management Policy defines "Equity" as shareholders' equity as shown on OCC's Statement of Financial Condition.

Equity fall below certain thresholds (the “Replenishment Plan”).<sup>6</sup> In addition, OCC’s Rules, the Capital Management Policy, and associated policies provide for the use of OCC’s current and retained earnings in excess of 110% of the Target Capital Requirement (i.e., the “Early Warning” threshold under OCC’s Replenishment Plan) to cover losses arising from a Clearing Member’s default.<sup>7</sup> While OCC’s Rules previously provided for OCC to contribute its own capital to cover default losses at the Board’s discretion, the Capital Management Policy changes made the contribution of such excess capital obligatory.<sup>8</sup>

In the event of a Clearing Member default, OCC would contribute excess capital to cover losses remaining after applying the margin assets and Clearing Fund contribution of the defaulting Clearing Member and before charging the Clearing Fund contributions of non-defaulting Clearing Members. Should OCC’s excess capital be insufficient to cover the loss, OCC also has another tranche of OCC resources in addition to the Clearing Fund; namely, the EDCP Unvested Balance.<sup>9</sup> In the event of a default loss, the EDCP Unvested Balance is contributed pari passu with the Clearing Fund contributions of non-defaulting Clearing Members.

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<sup>6</sup> See Exchange Act Release No. 88029 (Jan. 24, 2020), 85 FR 5500 (Jan. 30, 2020) (File No. SR-OCC-2019-007) (hereinafter, “Order Approving Capital Management Policy”).

<sup>7</sup> Id. at 5502.

<sup>8</sup> Use of excess capital to cover losses arising from the default of a bank or other clearing agency that is not otherwise associated with a Clearing Member default remains at the Board’s discretion. See Rule 1006(e)(ii).

<sup>9</sup> As defined in OCC’s Rules, the EDCP Unvested Balance consists of funds (x) deposited on or after January 1, 2020 in respect of its EDCP and (y) in excess of amounts necessary to pay for benefits accrued and vested under the EDCP at such time.

The implementation of OCC’s Capital Management Policy marked the first time OCC committed OCC’s own pre-funded financial resources into OCC’s approach to capital management and resiliency. In particular, OCC believes that the inclusion of the EDCP Unvested Balance is a powerful alignment of interest between management and Clearing Members. OCC takes seriously the interest of the industry and international regulators in seeing more significant skin-in-the-game commitments at central counterparties.

To that end, OCC has reviewed feedback received in connection with the initial filing of the Capital Management Plan, relevant papers from industry participants and stakeholders concerning skin-in-the-game, and regulatory regimes in jurisdictions outside the United States. For one, a comment submitted in connection with the Capital Management Policy’s filing urged OCC to implement a “minimum amount of skin-in-the-game that ‘scales with risk and is defined and funded upfront’ and . . . ‘to define a level of [skin-in-the-game] ex ante that would always be readily available in case of a default loss.’”<sup>10</sup> OCC has also reviewed the paper, “A Path Forward for CCP Resilience, Recover, and Resolution,” originally released in October 2019 with nine signatories and re-released in March of 2020 with ten additional signatories, representing major buy-side and sell-side firms in the markets OCC serves.<sup>11</sup> One of the paper’s significant recommendations is that central counterparties should have skin-in-the-game in a more

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<sup>10</sup> Order Approving Capital Management Policy, 85 FR at 5507 (quoting comments submitted by FIA).

<sup>11</sup> See ABN AMRO Clearing Bank N.V., et al., A Path Forward for CCP Resilience, Recovery, and Resolution (March 10, 2020), available at <https://www.jpmorgan.com/solutions/cib/markets/a-path-forward-for-ccp-resilience-recovery-and-resolution>.

defined manner.<sup>12</sup> In contrast, OCC’s current variable approach to skin-in-the-game does not guarantee a defined amount would be available as skin-in-the-game. Additionally, as OCC seeks recognition in the European Union and the United Kingdom, OCC is cognizant of the European Market Infrastructure Regulation’s (“EMIR”) expectation that skin-in-the-game be a minimum of 25% of the central counterparty’s regulatory capital requirement.<sup>13</sup> Under the current Capital Management Policy, excess capital is not dedicated solely as skin-in-the-game and it is possible that OCC’s capital in excess of 110% of its Target Capital Requirement would be less than 25% of OCC’s Target Capital Requirement.

To address the concerns raised by these market participants, further strengthen OCC’s pre-funded financial resources, further align the interests of OCC’s management and Clearing Members, and align OCC’s skin-in-the-game with international standards,

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<sup>12</sup> While OCC agrees with the paper’s authors that central counterparties should have meaningful skin-in-the-game, OCC does not agree with the level of skin-in-the-game recommended in the paper. See *Optimizing Incentives, Resilience and Stability in Central Counterparty Clearing: Perspectives on CCP Issues from a Utility Model Clearinghouse* (September 22, 2020), available at <https://www.theocc.com/Newsroom/Insights/2020/09-22-Optimizing-Incentives,-Resilience-and-Stabil>.

<sup>13</sup> Though OCC, as a non-EU central counterparty, would not be subject directly to the EMIR standards or the supervision of the European Securities and Markets Authority (“ESMA”), OCC has considered the EMIR standards as part of its bid to seek third-country recognition in Europe and the United Kingdom. OCC is seeking recognition to address European bank capital requirements set to go into effect next year that would require European banks to set aside additional capital for exposure to central counterparties that are not “qualified CCPs” in Europe. In order to become a qualified CCP, ESMA and the regulatory authority in a non-EU jurisdiction must reach an agreement that their regulatory regimes for central counterparties are equivalent. As of the date of this filing, the Commodity Futures Trading Commission (“CFTC”) has reached an agreement with ESMA on the equivalence of their regulatory regimes.

OCC is filing this proposed rule change, which would establish a persistent minimum amount of skin-in-the-game that would be used to cover default losses and liquidity shortfalls. This skin-in-the-game proposal is part of a broader set of decisions announced by OCC to lower the cost of clearing for its members,<sup>14</sup> including a fee decrease effective September 1, 2020.<sup>15</sup> OCC also discussed these changes on calls with OCC’s Non-Equity Exchanges, Clearing Members, and other market participants, including discussions with the SIFMA Options Committee and FIA and open calls with OCC Clearing Members. Members expressed that the proposed addition of a minimum level of skin-in-the-game would be a welcome enhancement by OCC. One market participant expressed its appreciation for OCC’s commitment to resiliency, but renewed concerns it had raised in connection with OCC’s Capital Management Policy about increases in OCC’s capital and, if OCC were sold, a more commercial orientation monetized with higher fees. As OCC stated with respect to the establishment of the Capital Management Policy,<sup>16</sup> OCC believes that this view is well outside the scope of the Capital Management Policy and this proposed rule change, but will continue to engage with

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<sup>14</sup> OCC announced these decisions in a press release and letter to Clearing Members. See Press Release, OCC To Lower Costs for Users of U.S. Equity Derivatives Markets (Aug. 3, 2020), available at <https://www.theocc.com/Newsroom/Press-Releases/2020/08-03-OCC-To-Lower-Costs-for-Users-of-US-Equity-De>; “Letter to Clearing Member Firms – OCC to Lower Costs for Users of U.S. Equity Derivative Markets” (Aug. 3, 2020), available at <https://www.theocc.com/Newsroom/Views/2020/08-03-Letter-to-Clearing-Member-Firms>.

<sup>15</sup> See Exchange Act Release No. 89534 (Aug. 12, 2020), 85 FR 50858 (Aug. 18, 2020) (File No. SR-OCC-2020-009).

<sup>16</sup> See Exhibit 3g to File No. SR-OCC-2019-007.

Clearing Members and other market participants to address any concerns. While questions were raised in these conversations, no specific suggestions were made.

### **Proposed Changes**

In order to establish a persistent minimum amount of skin-in-the-game, OCC is proposing to: (a) amend OCC's Rules to define the Minimum Corporate Contribution, insert the Minimum Corporate Contribution in OCC's default waterfall as provided in Rule 1006, provide for how OCC would calculate any LNAFBE greater than 110% of its Target Capital Requirement OCC would contribute in addition to the Minimum Corporate Contribution, and provide a time by which OCC would reestablish the Minimum Corporate Contribution if and when OCC uses it to cover default losses; (b) amend the Capital Management Policy to exclude the Minimum Corporate Contribution from OCC's measurement of its LNAFBE against its Target Capital Requirement and from OCC's calculation of the Early Warning and Trigger Event, to ensure that OCC may maintain the Minimum Corporate Contribution exclusively for default losses while retaining access to replenishment capital in the event OCC suffers an operational loss that reduces its Equity below those thresholds; and (c) apply conforming changes to the Default Management Policy, Clearing Fund Methodology Policy, and the RWD Plan to reflect that in the event of a default loss or liquidity shortfall, the Minimum Corporate Contribution would be charged after contributing the margin and Clearing Fund deposit of a default member and before the contribution of OCC's LNAFBE in excess of 110% of OCC's Target Capital Requirement, both before OCC charges the Clearing Fund deposits of non-default Clearing Members and the EDCP Unvested Balance on a pro rata basis.

(a) Amendments to OCC's Rules

To establish and maintain a persistent minimum level of skin-in-the-game, OCC proposes to amend its Rules to (1) define the Minimum Corporate Contribution; (2) revise OCC's default waterfall to more clearly define the skin-in-the-game resources OCC would contribute to a default loss; (3) provide for how OCC would calculate any LNAFBE greater than 110% of the Target Capital Requirement it would contribute after exhausting the Minimum Corporate Contribution; and (4) provide for how OCC would replenish the Minimum Corporate Contribution after each chargeable default loss.

(1) *Defining the Minimum Corporate Contribution*

OCC would establish a persistent minimum level of skin-in-the-game by first amending OCC's Rules to define the Minimum Corporate Contribution in Chapter I of the Rules to mean the minimum level of OCC's own funds maintained exclusively to cover credit losses or liquidity shortfalls, the level of which OCC's Board shall determine from time to time. As OCC's own funds, OCC would hold the Minimum Corporate Contribution in accordance with OCC's By-Laws governing the investment of OCC's funds<sup>17</sup> and OCC's policies and procedures governing cash and investment management. Specifically, OCC maintains uninvested OCC cash in demand deposits and any investments of funds maintained to satisfy the Minimum Corporate Contribution would be limited to overnight reverse repurchase agreements involving U.S. Government Treasury Securities, consistent with OCC's same-day liquidity needs for such funds.

While the proposed definition would give OCC's Board discretion in setting the Minimum Corporate Contribution, the Board has approved an initial Minimum Corporate

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<sup>17</sup> See OCC By-Laws Art. IX, Sec. 1.

Contribution that sets OCC's total persistent skin-in-the-game (i.e., the sum of the Minimum Corporate Contribution and OCC's current EDCP Unvested Balance) at 25% of OCC's Target Capital Requirement. In setting the initial Minimum Corporate Contribution, OCC's Board considered factors including, but not limited to, the regulatory requirements in each jurisdiction in which OCC is registered or in which OCC is actively seeking recognition, the amount similarly situated central counterparties commit of their own resources to address participant defaults, the EDCP Unvested Balance, OCC's LNAFBE greater than 110% of its Target Capital Requirement, projected revenue and expenses, and other projected capital needs.

(2) *Revising OCC's Default Waterfall*

OCC would also amend OCC Rule 1006 to insert the Minimum Corporate Contribution in OCC's default waterfall after contributing a defaulting Clearing Member's margin and Clearing Fund deposit, and before contributing OCC's LNAFBE greater than 110% of OCC's Target Capital Requirement, both of which OCC would exhaust before charging a loss to the Clearing Fund and the EDCP Unvested Balance, pari passu with the Clearing Fund deposits of non-defaulting Clearing Members. So placed, OCC believes that the Minimum Corporate Contribution would demonstrate OCC's institutional commitment to its ongoing financial surveillance of clearing members and the establishment and maintenance of a prudent and effective margin methodology. A draw against the Minimum Corporate Contribution and the associated requirement to replenish, as discussed below, would provide fewer resources to meet other corporate commitments. Accordingly, the proposal would further align OCC's and its management's interests with those of non-defaulting Clearing Members.

OCC would also remove references to “retained earnings” or “current or retained earnings” in OCC Rule 1006(b), Rule 1006(e)(i), Rule 1006(e)(ii), and the second sentence of Rule 1006(e)(iii), and replace them with references to the contribution of the “Minimum Corporate Contribution” and “the Corporation’s liquid net assets funded by equity that are greater than 110% of its Target Capital Requirement.” The references to “retained earnings” or “current or retained earnings” are legacy terms used prior to OCC’s implementation of the Capital Management Policy.<sup>18</sup> OCC is proposing to replace these references in OCC’s Rules to better identify the funds OCC’s would contribute in terms that align with OCC’s Capital Management Policy.

(3) *Calculating LNAFBE Available as Skin-In-The-Game*

Because OCC proposes to replace references to “current or retained earnings,” OCC would also delete the first sentence of Rule 1006(e)(iii), which currently provides for how OCC determines its “current earnings” for purposes of the amount available to cover losses under Rule 1006(e)(i) and Rule 1006(e)(ii). In its place, the first sentence of Rule 1006(e)(iii) would set out how OCC would determine its LNAFBE for purposes of contributing LNAFBE greater than 110% of the Target Capital Requirement to cover default losses and liquidity shortfalls. Specifically, similar to how the Rules currently provide for the calculation of “current earnings,” OCC would determine its LNAFBE

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<sup>18</sup> OCC first established discretionary use of OCC’s current or retained earnings to cover default losses in Article VIII (Clearing Fund) of OCC’s By-Laws. See Exchange Act Release No. 15493 (Jan. 4, 1979), 44 FR 3802 (Jan. 18, 1979) (File No. SR-OCC-79-01). When OCC moved the provisions governing the Clearing Fund from OCC’s By-Laws to the Rules in 2018, the provisions governing the usage of the Clearing Fund became Rule 1006(e). See Exchange Act Release No. 83735 (July 27, 2018), 83 FR 37855 (Aug. 2, 2018) (File No. SR-OCC-2018-008).

based on OCC's unaudited financial statements at the close of the calendar month immediately preceding the occurrence of the loss or deficiency under paragraphs (e)(i) or (e)(ii), less an amount equal to the aggregate of all refunds made or authorized to be made or deemed to have been made during the fiscal year in which such loss or deficiency occurs if the refund is not reflected on such unaudited financial statements. Accordingly, OCC would retain the priority given to the payment of refunds that OCC has declared, but not yet issued, as currently provided by OCC Rule 1106(e)(iii), when calculating the amount of LNAFBE available to cover a default loss after contributing the Minimum Corporate Contribution.

OCC would further amend Rule 1006(e)(iii) to provide that in no event shall OCC be required to contribute an amount that would cause OCC's LNAFBE to fall below 110% of the Target Capital Requirement at the time changed. The Capital Management Policy, in accordance with SEC Rule 17Ad-22(e)(15)(ii)(A),<sup>19</sup> currently requires that the funds OCC maintains to satisfy its Target Capital Requirement be separate from OCC's resources to cover participant defaults and liquidity shortfalls. Accordingly, should a default occur in a month during which OCC suffers an operational loss that decreases the value of its excess capital available as skin-in-the-game below what is reflected on the unaudited financial statement at the close of the previous month,<sup>20</sup> OCC would be able to take into account the decrease in its excess capital when calculating its available

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<sup>19</sup> 17 CFR 240.17Ad-22(e)(15)(ii)(A).

<sup>20</sup> Under OCC's current rules, LNAFBE greater than 110% of the Target Capital Requirement and the EDCP Unvested Balance are committed to cover both operational losses and default losses. In the event OCC experiences operational losses and default losses in short succession, OCC would contribute these resources in the manner specified by OCC's Rules to the event that occurred first.

LNAFBE above 110% of the Target Capital Requirement. In addition, OCC would renumber as Rule 1006(e)(iv) the last sentence of Rule 1006(e)(iii). That sentence, which concerns a defaulting Clearing Member's continuing obligation for losses OCC charges to OCC's own capital, is conceptually distinct from the rest of Rule 1006(e)(iii) and, accordingly, deserves to be addressed separately.

(4) *Replenishing the Minimum Corporate Contribution*

Finally, OCC would add a new paragraph to Rule 1006(e)—Rule 1006(e)(v)—to provide for a 270 calendar-day period during which the Minimum Corporate Contribution, once charged, would be reduced to the remaining unused portion. OCC believes that 270 calendar days, or approximately nine months, is sufficient time for OCC to accumulate the funds necessary to reestablish the Minimum Corporate Contribution. In making this determination, OCC used the same analysis employed to set the Early Warning and Trigger Event under its Replenishment Plan, both of which are based on the time OCC estimates it would take to accumulate 10% of its Target Capital Requirement.<sup>21</sup> Specifically, OCC took into account its typical monthly earnings and the amount of earnings that would be needed to replenish the Minimum Corporate Contribution on an after-tax basis. Proposed Rule 1006(e)(v) would also provide that OCC shall notify Clearing Members of any such reduction to the Minimum Corporate Contribution.

Each chargeable loss would trigger a new 270-day period. As such, proposed Rule 1006(e)(v) is designed to allow OCC to manage multiple defaults within a 270-day

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<sup>21</sup> See Order Approving Capital Management Policy, 85 FR at 5510-11. OCC has included this analysis as part of confidential Exhibit 3 to File No. SR-OCC-2021-003.

period by eliminating the risk that a successive default would exhaust the resources needed to reestablish the Minimum Corporate Contribution by the end of the initial 270-day period. And while a successive default loss that does not impact excess LNAFBE<sup>22</sup> available to replenish the Minimum Corporation Contribution would nevertheless trigger another 270-day period during which the Minimum Corporate Contribution would be reduced to the remaining unused portion after the first two defaults, any LNAFBE greater than 110% of the Target Capital Requirement would continue to be available to cover successive default losses. In the very unlikely event that OCC experiences an operational loss or a drop in revenue from clearing fees that threatens its ability to reestablish the Minimum Corporate Contribution at the end of the 270-day period, OCC would likely file a rule change to extend the period rather than act to lower the Minimum Corporate Contribution, dependent on the Board's consideration of the same non-exclusive list of factors that the Board would consider when determining whether to adjust the Minimum Corporate Contribution, discussed below.

(b) Amendments to the Capital Management Policy

Consistent with the proposed changes to OCC's Rules, OCC would amend the portions of the Capital Management Policy that concern OCC's usage of excess capital to cover default losses to more specifically identify the resources OCC would contribute to default losses; namely, the Minimum Corporate Contribution and LNAFBE above 110% of the Target Capital Requirement. OCC would clarify that after exhausting the

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<sup>22</sup> As described below, OCC is proposing to amend the Capital Management Policy to exclude the Minimum Corporate Contribution from the definition of LNAFBE. As a result, a second default loss covered exclusively by the Minimum Corporate Contribution would not impact OCC's level of LNAFBE.

Minimum Corporate Contribution, OCC would continue to offset default losses with LNAFBE, rather than “Equity,” above 110% of the Target Capital requirement. This change is not intended to change OCC’s current obligations. Rather, OCC intends to conform the Capital Management Policy so that the terms are consistent with those used in the proposed Rules, other requirements in the Capital Management Policy, and OCC’s regulatory obligations. Specifically, the Capital Management Policy provides that the resources held to meet the Target Capital Requirement must be liquid assets separate from OCC’s resources to cover participant defaults and liquidity shortfalls, consistent with SEC Rule 17Ad-22(e)(15)(ii)(A).<sup>23</sup> Because Equity typically exceeds LNAFBE and because any funds OCC would contribute to cover a default loss would need to be liquid assets, contributing liquid assets in excess of LNAFBE greater than 110% of the Target Capital Requirement would be inconsistent with the Capital Management Policy.

In addition, OCC would amend the Capital Management Policy’s list of capital management actions with a material impact on current or future levels of Equity, replacing “use of current and retained earnings greater than 100% of the Target Capital Requirement” with “use of excess capital,” to align with the title of the Capital Management Policy’s “Excess Capital Usage” section. That section would also be updated to include a discussion of the factors that the Board would consider in establishing and adjusting the Minimum Corporate Contribution. Factors the Board would consider include, but are not limited to, the regulatory requirements in each jurisdiction in which OCC is registered or in which OCC is actively seeking recognition, the amount similarly situated central counterparties commit of their own resources to

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

address participant defaults, the current and projected level of the EDCP Unvested Balance, OCC's LNAFBE greater than 110% of its Target Capital Requirement, projected revenue and expenses, and other projected capital needs. While the Capital Management Policy would provide that the Board would review Minimum Corporate Contribution annually, the Board would retain authority to change the Minimum Corporate at its discretion. In addition, the Capital Management Policy would be updated to include the substance of and references to proposed Rule 1006(e)(v), which, as discussed above, provides for a 270-day period following a chargeable loss during which the Minimum Corporate Contribution is reduced to its remaining unused portion.

OCC would also amend the definition of LNAFBE in the Capital Management Policy to specifically exclude the Minimum Corporate Contribution, which would be dedicated to cover default losses. The Capital Management Policy defines LNAFBE as the level of cash and cash equivalents, no greater than Equity, less any approved adjustments. The definition currently specifies the exclusion of "agency-related liabilities, such as Section 31 fees" as the only approved adjustment. OCC would amend the definition to add the Minimum Corporate Contribution as another example of an approved exemption to the calculation of LNAFBE. As discussed in more detail in the discussion of the statutory basis for these proposed changes below, this proposed amendment to the definition of LNAFBE is intended to ensure that OCC does not double count resources committed to cover default losses as resources available to satisfy regulatory requirements concerning the amount of LNAFBE or other financial resources OCC must maintain to cover operational costs and potential business losses. For similar reasons, OCC would amend the Capital Management Policy's discussion of OCC's

Replenishment Plan to add that in the event of an operational loss, OCC shall first use Equity, “less the Minimum Corporate Contribution,” above 110% of Target Capital. This amendment reflects that the funds maintained for the Minimum Corporate Contribution are not funds available to cover operational losses.

With respect to OCC’s Replenishment Plan, OCC would also amend the definitions of the Early Warning and Trigger Event to exclude the Minimum Corporate Contribution from the calculation of those thresholds so that OCC maintains access to replenishment capital in the event operational losses materialize while still maintaining the Minimum Corporate Contribution exclusively to cover default losses. As described above, the Early Warning and Trigger Event are the thresholds for actions under OCC’s Replenishment Plan. Currently, the Early Warning and Trigger Event thresholds are defined with respect to OCC’s Equity falling below certain thresholds. OCC is proposing to amend those definitions so that the Early Warning and Trigger Event occur when Equity “less the Minimum Corporate Contribution” falls below those same thresholds. These changes would ensure that OCC may maintain the Minimum Corporate Contribution exclusively to address default losses—the effect of which would be to increase Equity relative to LNAFBE—while still maintaining access to its Replenishment Plan should OCC’s Equity, less the Minimum Corporate Contribution, fall close to or below the Target Capital Requirement.

(c) Amendments to the Default Management Policy, Clearing Fund Methodology Policy, and RWD Plan

To accommodate the proposed establishment of the Minimum Corporate Contribution, OCC proposes conforming changes to other rule-filed policies that describe OCC’s default waterfall, as set forth in OCC Rule 1006. In the Default Management

Policy, OCC would delete the passage concerning “Current and Retained Earnings” in the current discussion of OCC’s default waterfall and replace it with the Minimum Corporate Contribution and LNAFBE greater than 110% of the Target Capital Requirement, as provided in the proposed amendments to Rule 1006 above. OCC would also amend the Default Management Policy’s definition of “financial resources” to include the Minimum Corporate Contribution as among those available to address Clearing Member defaults and suspensions. In the Clearing Fund Methodology Policy, OCC would similarly revise the discussion of the default waterfall in that policy’s section covering Clearing Fund charges and assessments to incorporate the Minimum Corporate Contribution, consistent with the proposed amendments to Rule 1006 above. OCC would also amend the Clearing Fund Methodology Policy’s definitions of OCC’s “Pre-Funded Financial Resources” for the purposes of sizing or measuring the sufficiency of the Clearing Fund to include the Minimum Corporate Contribution. Finally, OCC would amend the RWD Plan to replace all references to “current or retained earnings” with the Minimum Corporate Contribution and LNAFBE greater than 110% of the Target Capital Requirement, or “skin-in-the-game” for short, modify certain example scenarios concerning use of OCC’s Enhanced Risk Management and Recovery Tools to account for the proposed Minimum Corporate Contribution, and make certain other conforming changes concerning use of skin-in-the-game to address liquidity shortfalls and, in the case of LNAFBE greater than 110% of the Target Capital Requirement, OCC’s authority to use skin-in-the-game to address losses resulting from bank or securities or commodities clearing organization failures, including custody or investment losses.

(2) Statutory Basis

OCC believes the proposed rule changes are 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 proposed establishment of the Minimum Corporate Contribution and other proposed changes are consistent with Section 17A(b)(3)(F) of the Exchange Act<sup>24</sup> and Rules 17Ad-22(e)(2)(i),<sup>25</sup> 17Ad-22(e)(4),<sup>26</sup> 17Ad-22(e)(15)(ii)(A),<sup>27</sup> 17Ad-22(e)(15)(iii),<sup>28</sup> and Rule 17Ad-22(e)(23)<sup>29</sup> thereunder for the reasons described below.

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 proposed revisions to the Capital Management Policy’s definitions of LNAFBE, Early Warning and Trigger Event are designed to ensure that OCC may establish the Minimum Corporate Contribution exclusively to cover default losses while continuing to maintain sufficient LNAFBE for operational expenses such that it could continue to promptly and accurately clear and settle securities transactions even if it suffered significant operational losses, including by continuing to maintain access to its Replenishment Plan should an operational loss cause OCC’s Equity, less the Minimum Corporate Contribution, to fall

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

<sup>25</sup> 17 CFR 240.17Ad-22(e)(2)(i).

<sup>26</sup> 17 CFR 240.17Ad-22(e)(4).

<sup>27</sup> 17 CFR 240.17Ad-22(e)(15)(ii).

<sup>28</sup> 17 CFR 240.17Ad-22(e)(15)(iii).

<sup>29</sup> 17 CFR 240.17Ad-22(e)(23).

close to or below OCC's Target Capital Requirement. In other words, conforming these definitions to account for the establishment of the Minimum Corporate Contribution, which will not be available to cover operational losses, ensures that OCC will continue to hold sufficient LNAFBE separate from the Minimum Corporate Contribution and maintain access to its Replenishment Plan to absorb operational losses and avoid a disruption that could negatively impact OCC's prompt and accurate clearing and settlement of transactions. Therefore, OCC believes that the proposed amendments to the definitions of LNAFBE, Early Warning and Trigger Event under its Capital Management Policy, which are reasonably designed to ensure that OCC has sufficient LNAFBE to continue operations in the event of an operational loss, are consistent with the requirements of Section 17A(b)(3)(F) of the Exchange Act by protecting investors and the public interest.<sup>30</sup>

Rule 17Ad-22(e)(4) under the Exchange Act 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>31</sup> By providing that OCC shall maintain a minimum level of skin-in-the-game—in addition to OCC's LNAFBE greater than 110% of its Target Capital Requirement, contributed prior to charging the Clearing Fund, as OCC's Rules currently provide—OCC is providing for a minimum level of pre-funded

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<sup>30</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>31</sup> 17 CFR 240.17Ad-22(e)(4)(i).

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, the Capital Management Policy, and other related policies to establish the Minimum Corporate Contribution are consistent with Rule 17Ad-22(e)(4).

OCC also believes that the proposed changes to the definition of LNAFBE in OCC's Capital Management Policy, which exclude the Minimum Corporate Contribution from the calculation of LNAFBE, are consistent with Rule 17Ad-22(e)(15)(ii)(A) under the Exchange Act.<sup>32</sup> Rule 17Ad-22(e)(15)(ii)(A) requires that the LNAFBE held by OCC to satisfy the minimum LNAFBE required by Rule 17Ad-22(e)(15)(ii)<sup>33</sup> shall be in addition to resources held to cover participant defaults or other credit or liquidity risks.<sup>34</sup>

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

<sup>33</sup> Rule 17Ad-22(e)(15)(ii), in turn, requires that OCC hold LNAFBE to the greater of (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. 17 CFR 240.17Ad-22(e)(15)(ii). OCC's Capital Management Policy is reasonably designed to meet this requirement, and Rule 17Ad-22(e)(15) more broadly, by providing that OCC sets 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 winddown of critical operations and services, 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. See Order Approving Capital Management Policy, 85 FR at 5501-02. In addition, in setting the Target Capital Requirement, OCC's Board considers OCC's projected rolling twelve-months' operating expenses to ensure that OCC maintains Equity and other financial resources approved by the CFTC, as required by CFTC Rule 39.11(a)(2). See id. at 5501 n.19 (citing 17 CFR 39.11(a)(2)).

<sup>34</sup> Id. Similarly, CFTC Rule 39.11(b)(3) provides that a derivatives clearing organization ("DCO") may allocate financial resources to satisfy requirements that the DCO possess financial resources (i) to enable the DCO to meet obligations notwithstanding a default by the clearing member creating the largest

The proposed revision to OCC’s definition of LNAFBE is designed to satisfy Rule 17Ad-22(e)(15)(ii)(A) by providing that the proposed Minimum Corporate Contribution, which would be held exclusively to cover participant defaults and liquidity shortfalls, would be in addition to the LNAFBE that OCC holds to meet or exceed its regulatory capital requirements under Rule 17Ad-22(e)(15)(ii)—i.e., LNAFBE in an amount equal to 110% of OCC’s Target Capital Requirement. In addition, the proposed revisions to OCC Rule 1006(e)(iii) and the Capital Management Policy—which would specify that OCC’s committed skin-in-the-game shall include the Minimum Corporate Contribution and LNAFBE greater than 110% of the Target Capital Requirements—are reasonably designed to ensure that OCC would not be obligated to contribute an amount of skin-in-the-game that would cause its LNAFBE to fall below the Early Warning threshold intended to ensure OCC maintains sufficient LNAFBE to meet its regulatory obligations. As a result, OCC believes the proposed amendments to the Capital Management Policy are designed to comply with Rule 17Ad-22(e)(15)(ii)(A).

In addition, OCC believes that the proposed amendments to OCC’s definition of the Early Warning and Trigger Event thresholds under OCC’s Replenishment Plan are consistent with Rule 17Ad-22(e)(15)(iii)<sup>35</sup> because excluding the Minimum Corporate Contribution from those thresholds would ensure that OCC may continue to access replenishment capital in the unlikely event that OCC experiences an operational loss while continuing to maintain the Minimum Corporate Contribution exclusively to cover

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financial exposure for the DCO in extreme but plausible market conditions, and (ii) to enable the DCO to cover its operational costs, but not both. See 17 CFR 39.11(b)(3).

<sup>35</sup> 17 CFR 240.17Ad-22(e)(15)(iii).

default losses. Rule 17Ad-22(e)(15)(iii) requires, in part, 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 for raising additional Equity should its Equity fall close to or below the amount required under Rule 17Ad-22(e)(15)(ii).<sup>36</sup> By setting the threshold triggers by reference to the Target Capital Requirement, OCC's Replenishment Plan is designed to require OCC to act to raise capital should its Equity fall close to or below the amounts required under Rule 17Ad-22(e)(15)(ii). However, the effect of holding the Minimum Corporate Contribution would be to increase OCC's Equity relative to LNAFBE available to cover potential operational losses. To help ensure that OCC holds LNAFBE above its Target Capital Requirement and maintains access to replenishment capital, the proposed change would exclude the Minimum Corporate Contribution when measuring OCC's Equity against the Early Warning and Trigger Event thresholds under its Replenishment Plan. Accordingly, OCC believes that the proposed amendments to the definitions of the Early Warning and Trigger Event thresholds are consistent with Rule 17Ad-22(e)(15)(iii).

OCC also believe that the proposed changes are consistent with Rule 17Ad-22(e)(2)(i), which requires that covered clearing agencies maintain written policies and procedures reasonably designed to provide for governance arrangements that are clear and transparent.<sup>37</sup> The proposed changes would align the terminology used in OCC's Rules and other rule-filed policies with the terminology of the Capital Management Policy,

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<sup>36</sup> Id. As discussed in note 33, supra, OCC's Target Capital Requirement is reasonably designed to meet or exceed the minimum LNAFBE required to satisfy Rule 17Ad-22(e)(15)(ii).

<sup>37</sup> 17 CFR 240.17Ad-22(e)(2)(i).

providing better clarity and consistency between OCC's governing documents. Specifically, OCC would amend its Rules, Capital Management Policy, Default Management Policy, Clearing Fund Methodology Policy and RWD Plan to identify OCC's sources of skin-in-the-game (the Minimum Corporation Contribution, LNAFBE greater than 110% of the Target Capital Requirement, and the EDCP Unvested Balance) and their places within OCC's default waterfall. The proposed amendments to the Capital Management Policy would also identify factors the Board would consider in setting and adjusting the Minimum Corporate Contribution. Accordingly, OCC believes conforming the terms in these governance arrangements and identifying factors OCC would consider in adjusting the Minimum Corporate Contribution is consistent with Rule 17Ad-22(e)(2)(i).

Finally, OCC believe that the proposed changes are consistent with Rule 17Ad-22(e)(23), which requires covered clearing agencies to maintain written policies and procedures reasonably designed to, among other things, provide for publicly disclosing all relevant rules and material procedures, including key aspects of its default rules and procedures.<sup>38</sup> The proposed changes would amend OCC's Rules to remove the pre-Capital Management Policy references to use of "retained earnings" or "current and retained earnings" with respect to the sources of OCC's skin-in-the-game, and instead identify the Minimum Corporate Contribution and LNAFBE greater than 110% of the Target Capital Requirement. The proposed changes would also provide greater clarity about how OCC calculates the amount of LNAFBE greater than 110% of the Target Capital Requirement based upon the unaudited financial statements from the close of the prior month; provided,

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<sup>38</sup> 17 CFR 240.17Ad-22(e)(23).

however, that OCC would not be required to contribute an amount that would cause its LNAFBE to fall below 110% of the Target Capital Requirement at the time charged. The proposed changes to OCC Rules would, in turn, be made available on OCC's website. Therefore, OCC believes the proposed changes would disclose relevant default rules and procedures to the public and to Clearing Members.

(B) Clearing Agency's Statement on Burden on Competition

Section 17A(b)(3)(I) of the Exchange Act<sup>39</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 does not believe that the establishment of a Minimum Corporate Contribution and the other attendant changes discussed above have any impact, or impose any burden, on competition. As discussed above, OCC would charge the Minimum Corporate Contribution to cover a default loss or liquidity shortfall after charging the margin and Clearing Fund deposit of a default Clearing Member, and before charging OCC's LNAFBE above 110% of the Target Capital Requirement, both of which would be exhausted before OCC charged a default loss to the Clearing Fund deposits of non-defaulting members and the EDCP Unvested Balance on a pro rata basis. Accordingly, all Clearing Members would benefit by the establishment of the Minimum Corporate Contribution, which would provide a persistent minimum level of skin-in-the-game to absorb default losses or liquidity shortfalls prior to charging such losses to non-defaulting Clearing Members.

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

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

Written comments on the proposed rule change 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 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-2021-003 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-2021-003. 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/Company-Information/Documents-and-Archives/By-Laws-and-Rules>.

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-2021-003 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>40</sup>

J. Matthew DeLesDernier  
Assistant Secretary

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<sup>40</sup> 17 CFR 200.30-3(a)(12).