

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-82056; File No. SR-OCC-2017-806)

November 13, 2017

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of  
Advance Notice Concerning Liquidity for Same-Day Settlement

Pursuant to Section 806(e)(1) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, entitled Payment, Clearing and Settlement Supervision Act of 2010 (“Clearing Supervision Act”)<sup>1</sup> and Rule 19b-4(n)(1)(i) of the Securities Exchange Act of 1934 (“Act”),<sup>2</sup> notice is hereby given that on October 13, 2017, The Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission (“Commission”) an advance notice 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 advance notice from interested persons.

I. Clearing Agency’s Statement of the Terms of Substance of the Advance Notice

This advance notice is filed in connection with a proposed change to modify the tools available to OCC in order to provide a mechanism for addressing the risks of liquidity shortfalls, specifically, in the extraordinary situation where OCC faces a liquidity need to meet its same-day settlement obligations as a result of a bank or securities or commodities clearing organization failing to achieve daily settlement.

The proposed changes to OCC’s By-Laws were submitted as Exhibit 5 of the filing.<sup>3</sup> The proposed change is described in detail in Item 10 below. All terms with

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<sup>1</sup> 12 U.S.C. 5465(e)(1).

<sup>2</sup> 17 CFR 240.19b-4(n)(1)(i).

<sup>3</sup> OCC has filed a proposed rule change with the Commission in connection with the proposed change. See SR-OCC-2017-017.

initial capitalization not defined herein have the same meaning as set forth in OCC's By-Laws and Rules.<sup>4</sup>

II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Advance Notice

In its filing with the Commission, OCC included statements concerning the purpose of and basis for the advance notice and discussed any comments it received on the advance notice. 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 and B below, of the most significant aspects of these statements.

(A) Clearing Agency's Statement on Comments on the Advance Notice Received from Members, Participants or Others

Written comments were not and are not intended to be solicited with respect to the proposed change and none have been received. OCC will notify the Commission of any written comments received by OCC.

(B) Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing, and Settlement Supervision Act

**Description of the Proposed Change**

The purpose of the proposed change is to modify the tools available to OCC in order to provide a mechanism for addressing the risks of liquidity shortfalls, specifically, in the extraordinary situation where OCC faces a liquidity need to meet its same-day settlement obligations as a result of a bank or securities or commodities clearing

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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>. Other terms not defined herein or in the OCC By-Laws and Rules can be found in the Rules & Procedures of NSCC ("NSCC Rules"), available at [http://www.dtcc.com/~media/Files/Downloads/legal/rules/nsccl\\_rules.pdf](http://www.dtcc.com/~media/Files/Downloads/legal/rules/nsccl_rules.pdf), as the context implies.

organization failing to achieve daily settlement.

### **Current Practice**

Presently, Article VIII, Section 5(e) of OCC's By-Laws provides OCC with the authority to borrow against the Clearing Fund in two circumstances. First, Article VIII, Section 5(e) of OCC's By-Laws provides OCC the authority to borrow where OCC "deems it necessary or advisable to borrow or otherwise obtain funds from third parties in order to meet obligations arising out of the default or suspension of a Clearing Member or any action taken by the Corporation in connection therewith pursuant to Chapter XI of the Rules or otherwise." Second, Article VIII, Section 5(e) of OCC's By-Laws provides OCC the authority to borrow against the Clearing Fund where OCC "sustains a loss reimbursable out of the Clearing Fund pursuant to [Article VIII, Section 5(b) of OCC's By-Laws] but [OCC] elects to borrow or otherwise obtain funds from third parties in lieu of immediately charging such loss to the Clearing Fund." In order for a loss to be reimbursable out of the Clearing Fund under Article VIII, Section 5(b) of OCC's By-Laws, it must arise from a situation in which any bank or securities or commodities clearing organization has failed "to perform any obligation to [OCC] when due because of its bankruptcy, insolvency, receivership, suspension of operations, or because of any similar event."<sup>5</sup>

Under either of the two aforementioned circumstances, OCC is authorized to borrow against the Clearing Fund for a period not to exceed 30 days, and during such period, the borrowing shall not affect the amount or timing of any charges otherwise

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<sup>5</sup> To the extent that a loss resulting from any of the events referred to in Article VIII, Section 5(b) is recoverable out of the Clearing Fund pursuant to Article VIII, Section 5(a), the provisions of Article VIII, Section 5(a) control and render the provisions of Article VIII, Section 5(b) inapplicable.

required to be made against the Clearing Fund pursuant to Article VIII, Section 5.

However, if any part of the borrowing remains outstanding after 30 days, then at the close of business on the 30th day (or the first Business Day thereafter) such amount must be considered an actual loss to the Clearing Fund, and OCC must immediately allocate such loss in accordance with Article VIII, Section 5.

### **Proposed Change**

While Article VIII, Section 5(e) of OCC's By-Laws currently provides for borrowing authority in the more extreme scenarios involving a bank's or securities or commodities clearing organization's bankruptcy, insolvency, receivership, suspension of operations or similar event, such authority does not extend to the similar, but less extreme scenarios in which a bank or securities or commodities clearing organization might be temporarily unable to timely make daily settlement with OCC for reasons other than its bankruptcy, insolvency, receivership or suspension of operations or similar events. An example of such a related scenario would be a disruption of the ordinary operations of a settlement bank that temporarily prohibits the bank from timely effecting settlement payments in accordance with OCC's daily settlement cycle.

The proposed change would expand upon the existing borrowing authority in Article VIII, Section 5(e) of OCC's By-Laws. As expanded, OCC would be authorized to borrow (or otherwise obtain funds through any means determined to be reasonable by the Executive Chairman, COO or CAO) against the Clearing Fund in the extraordinary event that OCC faces a liquidity need in order to complete same-day settlement. As specified in the proposed rule text, the funds obtained from any such transaction can be used only for their stated purpose, namely, to satisfy a need for liquidity for same-day

settlement. Consistent with the existing borrowing authority in Article VIII, Section 5(e) of OCC's By-Laws, OCC would be authorized to borrow against the Clearing Fund for a period not to exceed 30 days, and during such period, the funds obtained would not be deemed to be charges against the Clearing Fund, irrespective of how such funds are applied, and the borrowing shall not affect the amount or timing of any charges otherwise required to be made against the Clearing Fund pursuant to Article VIII, Section 5. However, in the unlikely event that any part of the borrowing were to remain outstanding after 30 days, then at the close of business on the 30th day (or the first Business Day thereafter), such amount would be considered an actual loss to the Clearing Fund, and OCC must immediately allocate such loss in accordance with Article VIII, Section 5.

Like the existing borrowing authority in Article VIII, Section 5(e) of OCC's By-Laws, OCC envisions that the proposed expanded authority only would be relevant in extraordinary circumstances and, even then, only would be used where OCC, exercising its discretion, believes the employment of this particular authority would be appropriate to address OCC's immediate liquidity need.

OCC proposes to amend Sections 1(a), 5(b) and 5(e) of Article VIII of its By-Laws in order to give effect to the expanded borrowing authority discussed herein. Section 5(e) of Article VIII of OCC's By-Laws would be amended to permit OCC to borrow against the Clearing Fund if it reasonably believes such borrowing is necessary to meet its liquidity needs for same-day settlement as a result of the failure of any bank or securities or commodities clearing organization to achieve daily settlement.

Section 1(a) of Article VIII of OCC's By-Laws would be amended to include conforming changes that would reflect that the purpose of the Clearing Fund includes

borrowing against the Clearing Fund as permitted under Section 5(e) of Article VIII of the By-Laws.

Section 5(b) of Article VIII of the By-Laws would be amended to include conforming changes that would declare that any borrowing remaining outstanding for less than 30 days may be considered, in OCC's discretion, an actual loss and the amount of any such loss then shall be charged proportionately against all Clearing Members' computed contributions to the Clearing Fund as fixed at the time, and any borrowing remaining outstanding on the 30th day shall be considered an actual loss to the Clearing Fund and the amount of any such loss shall be charged proportionately against all Clearing Members' computed contributions to the Clearing Fund as fixed at the time. OCC proposes to include discretionary authority to declare any borrowing outstanding for less than 30 days as an actual loss chargeable against the Clearing Fund because the proposed borrowing authority is intended only to address same-day liquidity needs, and intended to be promptly repaid upon the bank's or securities or commodities clearing organization's resolution of the temporary disruption. In the unlikely circumstance that a disruption of a bank or securities or commodities clearing organization is not timely resolved, OCC may need to exercise its discretion to declare an actual loss, depending on the size of the borrowing, to ensure that OCC replenishes its "Cover 1" financial resources.<sup>6</sup> The requirement to recognize any borrowing outstanding after 30 days as an actual loss chargeable against the Clearing Fund would be consistent with the

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<sup>6</sup> "Cover 1" financial resources refers to the requirement that a CCA maintains financial resources sufficient to enable it to cover the "default of the participant family that would potentially cause the largest aggregate credit exposure for the [CCA] in extreme but plausible market conditions." 17 CFR 240.17Ad-22(e)(7)(viii).

requirements of the borrowing authority currently permitted by Section 5(e) of Article VIII of the By-Laws.

**Expected Effect on and Management of Risk**

OCC believes the proposed change would enable it to better manage the risks associated with the failure of a settlement bank or securities or commodities clearing organization's to achieve timely settlement. As noted above, OCC's By-Laws currently provide for borrowing authority in the more extreme scenarios involving a bank's or securities or commodities clearing organization's bankruptcy, insolvency, receivership, suspension of operations or similar event, such authority does not extend to the similar, but less extreme scenarios in which a bank or securities or commodities clearing organization might be temporarily unable to timely make daily settlement with OCC for reasons other than its bankruptcy, insolvency, receivership or suspension of operations or similar events. The proposed change would expand upon this existing borrowing authority to allow OCC to borrow (or otherwise obtain funds through any means determined to be reasonable by the Executive Chairman, COO or CAO) against the Clearing Fund in the extraordinary event that OCC faces a liquidity need in order to complete same-day settlement. As a result, the proposed change would enhance OCC's ability to manage its liquidity risks and ensure that it is able to continue making timely settlements in the event of such a disruption.

As stated above, it is conceivable, though extremely unlikely, that a bank or securities or commodities clearing organization may fail to make timely settlement with OCC as a result of a temporary disruption to its ordinary operations. The proposed change would not alter this risk, but would provide OCC with a mechanism for

addressing it, should such risk ever be realized. The proposed mechanism for addressing this risk – discretionary authority to borrow from the Clearing Fund – would require OCC’s senior and executive management to exercise discretion and judiciousness and could, if ever deployed, present an arguably new, though very limited, risk to Clearing Members.

Modifying OCC’s existing authority to borrow against the Clearing Fund introduces a new, and potentially competing, demand on OCC’s Clearing Fund resources in that any amount of Clearing Fund resources borrowed to address the failure of a bank or securities or commodities clearing organization to make timely settlement would subtract from the available resources to address other losses that could be charged against the Clearing Fund (most common among those, losses related to Clearing Member defaults). To manage the potential for competing demands on Clearing Fund resources, OCC would exercise discretion and judiciousness in selecting when this new borrowing authority could be prudently deployed, in light of then-existing facts and circumstances. In the alternative, OCC’s could elect to deploy an alternative tool, such as OCC’s ability to extend the settlement window under Rule 505, if such tool would be more appropriate given anticipated demands on Clearing Fund resources in light of then-existing facts and circumstances. Because of the low probability that a bank or securities or commodities clearing organization would suffer a temporary disruption to its ordinary operations that could threaten its ability to make timely settlement, and the extremely low probability that such a disruption would result in the bank or securities or commodities clearing organization actually failing to make timely settlement, OCC believes that the potential for competing demands on Clearing Fund resources can be managed sufficiently through

the tools available in its default management rules, policies and procedures.<sup>7</sup>

The proposed change could arguably present a new, though very limited, risk to Clearing Members in that OCC's authority to borrow against the Clearing Fund would be expanded, albeit slightly, to permit borrowing in a new scenario where a bank or securities or commodities clearing organization fails to make timely settlement (but otherwise is not in bankruptcy, insolvency, receivership, suspension of operations or a similar state). In order for Clearing Members to be impacted by this risk, a borrowing under the proposed authority would need to be declared an actual loss by OCC prior to 30 days lapsing or remain outstanding for 30 days, at which point, such amount would be considered an actual loss to the Clearing Fund, and OCC would be required to immediately allocate such loss in accordance with Article VIII, Section 5. However, given that the proposed borrowing authority is intended to be deployed to address immediate liquidity needs arising from temporary disruptions of the ordinary operation of a bank or securities or commodities clearing organization, OCC believes that it is extremely unlikely that any amount of any such borrowing ultimately would need to be declared as an actual loss in advance of 30 days or remain outstanding for a period of 30 days. If, however, any amount of any such borrowing in fact did remain outstanding for longer than expected, OCC believes there would be a high probability that the bank or securities or commodities clearing organization in question has actually failed, and

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<sup>7</sup> In addition, the bank or securities or commodities clearing organization would need to be in deficit for the settlement cycle in question in order for OCC to face an immediate liquidity need. Further, OCC must reasonably anticipate an imminent or near imminent failure by one or more Clearing Members for there to be a potential competing demand on Clearing Fund resources. OCC believes that the alignment of all of these occurrences represents an extraordinarily low probability occurrence.

therefore entered bankruptcy, insolvency, receivership, suspension of operations or a similar state – which events would have independently triggered the already-existing borrowing authority in Article VIII, Section 5(e).

### **Consistency with the Clearing Supervision Act**

The stated purpose of the Clearing Supervision Act is to mitigate systemic risk in the financial system and promote financial stability by, among other things, promoting uniform risk management standards for systemically important financial market utilities and strengthening the liquidity of systemically important financial market utilities.<sup>8</sup>

Section 805(a)(2) of the Clearing Supervision Act<sup>9</sup> also authorizes the Commission to prescribe risk management standards for the payment, clearing and settlement activities of designated clearing entities, like OCC, for which the Commission is the supervisory agency. Section 805(b) of the Clearing Supervision Act<sup>10</sup> states that the objectives and principles for risk management standards prescribed under Section 805(a) shall be to:

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

The Commission has adopted risk management standards under Section 805(a)(2) of the Clearing Supervision Act and the Act in furtherance of these objectives and principles, including those standards adopted pursuant to the Commission rules cited

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<sup>8</sup> 12 U.S.C. 5461(b).

<sup>9</sup> 12 U.S.C. 5464(a)(2).

<sup>10</sup> 12 U.S.C. 5464(b).

below.<sup>11</sup> For the reasons set forth below, OCC believes that the proposed change is consistent with the risk management standards promulgated under Section 805(a) of the Clearing Supervision Act.<sup>12</sup>

Rule 17Ad-22(e)(7)(viii) requires that a covered clearing agency (“CCA”) address foreseeable liquidity shortfalls that would not be covered by the CCA’s liquid resources and seek to avoid unwinding, revoking, or delaying the same-day settlement of payment obligations.<sup>13</sup> As stated above, OCC believes that it could be foreseeable, though extremely unlikely, that a bank or securities or commodities clearing organization may fail to make timely settlement with OCC as the result of an event that does not result in a loss to OCC from the bankruptcy, insolvency, resolution, suspension of operations or similar event of such bank or securities or commodities clearing organization. The proposed change would improve OCC’s ability to address such situations by expanding OCC’s borrowing authority to enable OCC to borrow against the Clearing Fund in order to avoid disrupting its ordinary settlement cycle (and thusly, to avoid imposing the same disruption on Clearing Members).

### III. Date of Effectiveness of the Advance Notice and Timing for Commission Action

The proposed change may be implemented if the Commission does not object to the proposed change within 60 days of the later of (i) the date the proposed change was

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<sup>11</sup> 17 CFR 240.17Ad-22. See Securities Exchange Act Release Nos. 68080 (October 22, 2012), 77 FR 66220 (November 2, 2012) (S7-08-11) (“Clearing Agency Standards”); 78961 (September 28, 2016), 81 FR 70786 (October 13, 2016) (S7-03-14) (“Standards for Covered Clearing Agencies”). The Standards for Covered Clearing Agencies became effective on December 12, 2016. OCC is a “covered clearing agency” as defined in Rule 17Ad-22(a)(5) and therefore is subject to section (e) of Rule 17Ad-22.

<sup>12</sup> 12 U.S.C. 5464(b)(1) and (4).

<sup>13</sup> 17 CFR 240.17Ad-22(e)(7)(viii).

filed with the Commission or (ii) the date any additional information requested by the Commission is received. OCC shall not implement the proposed change if the Commission has any objection to the proposed change.

The Commission may extend the period for review by an additional 60 days if the proposed change raises novel or complex issues, subject to the Commission providing the clearing agency with prompt written notice of the extension. A proposed change may be implemented in less than 60 days from the date the advance notice is filed, or the date further information requested by the Commission is received, if the Commission notifies the clearing agency in writing that it does not object to the proposed change and authorizes the clearing agency to implement the proposed change on an earlier date, subject to any conditions imposed by the Commission.

OCC shall post notice on its website of proposed changes that are implemented.

The proposal shall not take effect until all regulatory actions required with respect to the proposal are completed.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the advance notice is consistent with the Clearing Supervision 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-2017-806 on the subject line.

Paper Comments:

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

All submissions should refer to File Number SR-OCC-2017-806. 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 advance notice that are filed with the Commission, and all written communications relating to the advance notice 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 the filing also will be available for inspection and copying at the principal office of OCC and on OCC's website at

[http://www.theocc.com/components/docs/legal/rules\\_and\\_bylaws/sr\\_occ\\_17\\_806.pdf](http://www.theocc.com/components/docs/legal/rules_and_bylaws/sr_occ_17_806.pdf).

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-2017-806 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

By the Commission.

Eduardo A. Aleman  
Assistant Secretary