

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-82247; File No. SR-OCC-2017-808)

December 8, 2017

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of Advance Notice, as Modified by Amendment No. 1, Concerning the Adoption of a New Minimum Cash Requirement for the Clearing Fund

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) under the Securities Exchange Act of 1934 (“Act”),<sup>2</sup> notice is hereby given that on November 14, 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. On November 22, 2017, OCC filed Amendment No. 1 to the advance notice.<sup>3</sup> 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 would (1) revise OCC’s By-Laws to adopt a new minimum cash requirement for the Clearing Fund; (2) revise OCC’s By-Laws to provide for the pass-through of interest earned on Clearing Fund cash held in OCC’s Federal Reserve bank account; (3) enact changes to OCC’s Fee

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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> In Amendment No. 1, OCC modified the proposed change to Article VIII, Section 4(a) of the By-Laws to clarify that interest earned on Clearing Fund cash deposits held at a Federal Reserve Bank accruing to the benefit of Clearing Members would be calculated daily based on each Clearing Member’s pro rata share of Clearing Fund cash. OCC did not propose any other changes to the filing in Amendment No. 1.

Policy that reflect the pass through of interest earned on Clearing Fund cash held in OCC's Federal Reserve bank account; and (4) make certain conforming changes to OCC's Rules and By-Laws to affect the aforementioned changes.

The proposed changes to OCC's By-Laws and Rules were submitted as Exhibits 5A and 5B of the filing, and OCC's Fee Policy was submitted as confidential Exhibit 5C of the filing.<sup>4</sup> The proposed change is described in detail in Item 10 below. All terms with initial capitalization not defined herein have the same meaning as set forth in OCC's By-Laws and Rules.<sup>5</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 rule change and none have been received. OCC will notify the Commission of any written comments received by OCC.

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<sup>4</sup> OCC has filed a proposed rule change with the Commission in connection with the proposed change. See SR-OCC-2017-019.

<sup>5</sup> OCC's By-Laws and Rules can be found on OCC's public website: <http://optionsclearing.com/about/publications/bylaws.jsp>.

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

**Description of the Proposed Change**

OCC proposes to establish a minimum cash contribution requirement for its Clearing Fund in order to increase the amount of qualifying liquid resources available to OCC to account for extreme scenarios that may result in liquidity demands exceeding OCC's current Cover 1 liquidity resources, as calculated under the current historically-based methodology, and provide for a more consistent level of cash resources in its available prefunded financial resources. The proposed rule change also would provide for the pass-through of interest income earned on such deposits to its Clearing Members. OCC's current practices and the proposed changes to such practices are described in more detail below.

**Current Practice**

Presently, Article VIII, Section 3(a) of OCC's By-Laws provides that Clearing Fund contributions shall be in the form of cash and Government securities, but neither OCC's By-Laws nor Rules provides a minimum cash requirement for contributions in the Clearing Fund. Article VIII, Section 4(a) of OCC's By-Laws allows for OCC to invest cash contributions to the Clearing Fund, partially or wholly, in OCC's account in Government securities, and to the extent that such contributions are not so invested they shall be deposited by OCC in a separate account or accounts for Clearing Fund contributions in approved custodians. Article VIII, Section 4(a) of OCC's By-Laws, however, presently does not account for the treatment of interest earned on cash deposits held in the OCC's Federal Reserve bank account.

**Proposed Change**

## ***1. Minimum Cash Clearing Fund Requirement***

OCC proposes to establish a minimum cash contribution requirement for its Clearing Fund in order to increase the amount of highly liquid resources available to OCC to account for extreme scenarios that may result in liquidity demands exceeding OCC's current Cover 1 liquidity resources, as calculated under the current historically-based methodology, and provide for a more consistent level of cash resources in its available prefunded financial resources.<sup>6</sup> Specifically, the proposed rule change would require that Clearing Members collectively contribute \$3 billion in cash to the Clearing Fund ("Cash Clearing Fund Requirement"). Each Clearing Member's proportionate share of the Cash Clearing Fund Requirement shall be equal in percentage to its proportionate share of the Clearing Fund as determined by the Clearing Fund allocation methodology in current Rule 1001.

OCC has historically sized its liquidity resources based on historically observed liquidity demands and analysis of potential large forecasted liquidity demands over at least the next twelve months. OCC forecasts its future daily settlement activity under normal market conditions (e.g., mark-to-market settlements, and settlements resulting from the expiration of derivatives contracts) and compares such demands to its resources to ensure that at all times it will maintain a positive liquidity position to meet settlement obligations.

OCC has performed an analysis of its stress liquidity demands based on a 1-in-70

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<sup>6</sup> OCC's Current Cover 1 liquidity resources are sized based on the liquidity needed to address exposures derived solely from historical results. Introducing the Cash Clearing Fund Requirement would increase OCC's liquidity resources to address the exposures observed in a stress liquidity analysis performed using proposed sizing stress tests for OCC's Clearing Fund.

year hypothetical market event. OCC started its analysis by selecting the largest historical peak monthly settlements that occurred over the historical look back period of data generated by the stress test system. It then also selected certain large non-expiration days to supplement the analysis. From this it estimated the mark-to-market and cash settled exercise and assignment obligations for the members driving the historical peak demand under the proposed stress tests scenario to determine the stressed peak demand. Through this analysis, OCC observed that peak stressed liquidity demands of the largest 1 or 2 members, which normally occur in conjunction with certain monthly expirations, can exceed the size OCC's committed liquidity facilities (which currently total \$3 billion). In these cases, while OCC did have cash in the Clearing Fund to supplement its liquidity resources, and the total of credit facilities and cash in the Clearing Fund did cover these peak stressed liquidity demands, OCC is unable to rely on these cash contributions to be present at any given time since there is no obligation on members to maintain any amount of their contribution in cash. As a result, OCC believes it is necessary to increase or otherwise ensure the availability of highly liquid resources in the Clearing Fund to account for extreme scenarios that may result in liquidity demands exceeding OCC's Cover 1 liquidity resources, as calculated under the current historically-based methodology. The proposed Cash Clearing Fund Requirement, when taken together with OCC's \$3 billion in committed liquidity facilities, would provide liquidity resources sufficient to cover 100% of the peak stressed liquidity demands of the largest 1 or 2 members observed in OCC's analysis.

In addition, the proposed changes would allow OCC's Executive Chairman, Chief Administrative Officer ("CAO"), or Chief Operating Officer ("COO"), upon providing

notice to the Risk Committee, to temporarily increase the amount of cash required to be maintained in the Clearing Fund up to an amount that includes the size of the Clearing Fund as determined in accordance with Rule 1001 for the month in question for the protection of OCC, clearing members or the general public. Any determination by the Executive Chairman, CAO and/or COO to implement a temporary increase in Clearing Fund size would (i) be based upon then-existing facts and circumstances, (ii) be in furtherance of the integrity of OCC and the stability of the financial system, and (iii) take into consideration the legitimate interests of Clearing Members and market participants.

The proposed rule change would require that any temporary increase in the Cash Clearing Fund Requirement be reviewed by the Risk Committee as soon as practicable, but in any event within 20 calendar days of the increase. In its review, the Risk Committee shall determine whether (1) the increase in the minimum Cash Clearing Fund Requirement is no longer required or (2) OCC's Clearing Fund contribution requirements and other related rules should be modified to ensure that OCC continues to maintain sufficient liquid resources to cover its largest aggregate payment obligations in extreme but plausible market conditions. In the event that the Risk Committee would determine to permanently increase the Cash Clearing Fund Requirement, OCC would initiate any regulatory approval process required to effect such a change.<sup>7</sup> A Clearing Member will be required to satisfy any increase in its required cash contribution pursuant to an increase in the Cash Clearing Fund Requirement no later than one hour before the close of the Fedwire on the business day following OCC's issuance of an instruction to

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<sup>7</sup> However, OCC will not decrease the Cash Clearing Fund Requirement while the regulatory approvals for a change in the Cash Clearing Fund Requirement are being obtained to ensure that OCC continues to maintain sufficient liquid resources to cover its liquidity demands during that time.

increase cash contributions.

These changes would be reflected in new paragraph (a)(i) of Section 3 of Article VIII of OCC's By-Laws, as well as in new Interpretation and Policy .04 to Section 3 of Article VIII.

## ***2. Interest Pass Through for Clearing Fund Cash Held at the Federal Reserve***

In connection with the proposed Cash Clearing Fund Requirement, substantially all of OCC's Clearing Fund deposits consisting of cash would be held in an account established by OCC at a Federal Reserve Bank.<sup>8</sup> OCC proposes that it would pass the interest income earned in such account through to its Clearing Members. As a result, OCC proposes to revise Article VIII, Section 4(a) of OCC's By-Laws to include a sentence to provide that any interest earned on cash deposits held at a Federal Reserve Bank shall accrue to the benefit of Clearing Members (calculated daily based on each Clearing Member's pro rata share of Clearing Fund cash deposits), provided that such Clearing Members have provided OCC with all tax documentation as OCC may from time to time require in order to effectuate such payment.<sup>9</sup>

## ***3. Changes to the Fee Policy to Accommodate Interest Passed Through to Clearing Members***

In order to accommodate the pass through of interest income, OCC would also amend its Fee Policy to add definitions for "Pass-Through Interest Revenue" and "Operating Expenses" to exclude from the calculation of the Business Risk Buffer

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<sup>8</sup> OCC notes that it would retain the discretion to maintain a small portion of Clearing Fund cash deposits in other accounts (e.g., accounts with commercial banks) for various reasons, including facilitating normal substitution activity by its Clearing Members.

<sup>9</sup> Article VIII, Section 4(a) currently states that all interest gained on cash Clearing Fund deposits belongs to OCC.

projected interest revenue and expense, respectively, related to the pass-through of earned interest from OCC to Clearing Members.<sup>10</sup> OCC also proposes to add a new example of the Business Risk Buffer calculation reflecting this change and make clarifying changes throughout the Policy to incorporate the use of the new defined terms. In addition, OCC proposes to amend the Fee Policy to remove references to “Proposed Rule 17Ad-22(e)(15)” to reflect the adoption of the Commission’s Covered Clearing Agency Standards.

#### ***4. Conforming Changes***

In conjunction with the aforementioned changes, OCC is also proposing to make four related conforming changes. First, OCC proposes to revise Interpretation and Policy .01 of Rule 1001 to reflect that the new minimum Clearing Fund size is \$3 billion (instead of \$1 billion) plus 110% of the size of OCC’s committed liquidity facilities, which conforms to the proposed new minimum cash requirement for the Clearing Fund. Second, OCC proposes to amend the definition of “Approved Custodian” in Article I, Section 1 of the By-Laws to clarify that the Federal Reserve Bank may also be an Approved Custodian, to the extent it is available to OCC. Third, OCC is proposing to delete existing Article VIII, Section 4(b), regarding the establishment of a segregated funds account for cash contributions to the Clearing Fund. The segregated funds account allows a Clearing Member to contribute cash to a bank or trust company account

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<sup>10</sup> While interest income earned by OCC from its Federal Reserve bank account would be passed on to its Clearing Members, OCC anticipates that it would charge a cash management fee to cover associated costs (*i.e.*, administrative and similar costs). OCC would file a separate proposed rule change with the Commission, subject to receiving all necessary regulatory approvals for the proposed changes described herein, prior to implementing any cash management fee.

maintained in the name of OCC, subject to OCC's exclusive control, but the account also includes the name of the Clearing Member and any interest accrues to the Clearing Member rather than OCC. OCC proposes to eliminate the account type because Clearing Members have not expressed interest in using such an account, no such accounts are in use today, and moving forward, substantially all cash Clearing Fund contributions will be held in OCC's account at the Federal Reserve Bank. Fourth, OCC proposes to introduce new language to Article VIII, Section 4(a) to clarify that cash contributions to the Clearing Fund that are deposited at approved custodians may be commingled with the Clearing Fund contributions of different Clearing Members.

**Expected Effect on and Management of Risk**

The proposal is expected to improve OCC's liquidity risk management by establishing the Cash Clearing Fund Requirement and by permitting OCC to temporarily increase that requirement. The Cash Clearing Fund Requirement would increase the amount of highly liquid resources available to OCC to account for extreme scenarios that may result in liquidity demands exceeding OCC's current Cover 1 liquidity resources, as calculated under the current historically-based methodology. The Cash Clearing Fund Requirement also would provide a more consistent level of cash resources in OCC's available prefunded financial resources, thereby further strengthening OCC's liquidity risk management.

The proposed ability to allow OCC to temporarily increase its minimum Clearing Fund cash up to an amount that includes the size of the Clearing Fund as determined in accordance with Rule 1001 is expected to enhance OCC's liquidity risk management by providing a process to effectively replenish the liquid resources that OCC may employ

during a stress event and would provide OCC with an additional means of addressing liquidity shortfalls that otherwise would not be covered by OCC's liquid resources and would provide a form of replenishment of OCC's liquid resources. OCC recognizes that exercising its authority to increase the minimum amount of cash in the Clearing Fund could potentially impose a liquidity constraint on its clearing members, and for this reason, OCC has limited its authority to increase the minimum amount of cash in the Clearing Fund to circumstances in which such increase would protect OCC, clearing members or the general public and required that any such increase be based upon then-existing facts and circumstances, be in furtherance of the integrity of OCC and the stability of the financial system, and take into consideration the legitimate interests of clearing members and market participants.

OCC expects that its proposal to pass through interest earned on Clearing Fund cash deposits at a Federal Reserve Bank ultimately may potentially benefit clearing members' by providing them with a comparatively higher rate of return on their deposited cash (as compared to a comparable account with a commercial bank). This potential increased rate of return may ultimately strengthen the financial position of certain of OCC's clearing members.

### **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>11</sup>

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<sup>11</sup> 12 U.S.C. 5461(b).

Section 805(a)(2) of the Clearing Supervision Act<sup>12</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>13</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 below.<sup>14</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>15</sup>

Rule 17Ad-22(e)(7)<sup>16</sup> requires that a covered clearing agency (“CCA”) establish,

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

<sup>13</sup> 12 U.S.C. 5464(b).

<sup>14</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>15</sup> 12 U.S.C. 5464(b)(1) and (4).

<sup>16</sup> 17 CFR 240.17Ad-22(e)(7).

implement, maintain and enforce written policies and procedures reasonably designed to effectively measure, monitor and manage liquidity risk that arises in or is borne by the CCA. Rule 17Ad-22(e)(7)(i)<sup>17</sup> requires CCAs to establish, implement, maintain, and enforce written policies and procedures reasonably designed to effectively measure, monitor, and manage the liquidity risk that arises in or is borne by OCC by maintaining sufficient liquid resources at the minimum in all relevant currencies to effect same-day settlement, and where appropriate, intraday and multiday settlement of payment obligations with a high degree of confidence under a wide range of stress scenarios, that includes but is not limited to, the default of the participant family that would generate the largest aggregate payment obligation for OCC in extreme but plausible market conditions. As explained above, OCC has performed an analysis of its stress liquidity demands using proposed sizing stress tests for the Clearing Fund and has observed that peak stressed liquidity demands of the largest 1 or 2 members, which normally occur in conjunction with certain monthly expirations, can exceed the size OCC's committed liquidity facilities (which currently total \$3 billion). OCC believes that the proposed minimum \$3 billion Cash Clearing Fund Requirement will adjust OCC's available liquidity resources to account for extreme scenarios that may result in liquidity demands exceeding OCC's Cover 1 liquidity resources. In this regard, OCC believes the proposed Cash Clearing Fund Requirement is designed to satisfy the requirements of Rule 17Ad-22(e)(7)(i).<sup>18</sup>

Further, Rule 17Ad-22(e)(7)(viii)<sup>19</sup> requires that a CCA address foreseeable

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

<sup>18</sup> 17 CFR 240.17Ad-22(e)(7)(i).

<sup>19</sup> 17 CFR 240.17Ad-22(e)(7)(viii).

liquidity shortfalls that would not be covered by its liquid resources and Rule 17Ad-22(e)(7)(ix)<sup>20</sup> requires that a CCA describe its process to replenish any liquid resources that it may employ during a stress event. OCC believes that the proposed authority to temporarily increase the minimum cash requirement from \$3 billion up to an amount that includes the size of the Clearing Fund (as determined in accordance with Rule 1001 for the month in question) would provide OCC with an additional means of addressing liquidity shortfalls that otherwise would not be covered by OCC's liquid resources. Further, because the Clearing Fund is a resource that is replenished in accordance with Section 6 of Article VIII of OCC's By-Laws, to the extent that Clearing Members are required to replenish their required contributions – in whole or in part – with cash following a proportionate charge during, the proposed change would provide a form of replenishment of OCC's liquid resources. In this regard, OCC believes the proposed authority to require up to an all cash Clearing Fund requirement is designed to satisfy the requirements of Rules 17Ad-22(e)(7)(viii) and (ix).<sup>21</sup>

### 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 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

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<sup>20</sup> 17 CFR 240.17Ad-22(e)(7)(ix).

<sup>21</sup> 17 CFR 240.17Ad-22(e)(7)(viii) and (ix).

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-2017-808 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-2017-808. 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 [https://www.theocc.com/components/docs/legal/rules\\_and\\_bylaws/sr\\_occ\\_17\\_808.pdf](https://www.theocc.com/components/docs/legal/rules_and_bylaws/sr_occ_17_808.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-2017-808 and should be submitted on or before [insert date 15 days from publication in the Federal Register].

By the Commission.

Eduardo A. Aleman

Assistant Secretary