

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-82352; File No. SR-OCC-2017-021)

December 19, 2017

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of a Proposed Rule Change Concerning Updates to and Formalization of OCC's Recovery and Orderly Wind-Down Plan

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder<sup>2</sup> notice is hereby given that on December 8, 2017, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("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

This proposed rule change by the OCC would formalize and update OCC's Recovery and Orderly Wind-Down Plan ("RWD Plan" or "Plan") consistent with the requirement applicable to OCC in Rule 17Ad-22(e)(3)(ii).<sup>3</sup> Pursuant to a temporary exemption issued by the Commission in April 2017, the compliance date for Rule 17Ad-22(e)(3)(ii) has been extended until December 31, 2017.<sup>4</sup>

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

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

<sup>3</sup> 17 CFR 240.17Ad-22(e)(3)(ii). The Commission's approval of this proposed rule change is contingent upon the prior approval of filings currently pending for certain of OCC's Enhanced Risk Management Tools and OCC's Recovery Tools. See SR-OCC-2017-016; SR-OCC-2017-017; SR-OCC-2017-018; SR-OCC-2017-019; SR-OCC-2017-020.

<sup>4</sup> See Exchange Act Release No. 34-80378 (April 5, 2017).

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

**Background**

On September 28, 2016 the Commission adopted amendments to Rule 17Ad-22<sup>5</sup> and added new Rule 17Ab2-2<sup>6</sup> pursuant to Section 17A of the Securities Exchange Act of 1934<sup>7</sup> and the Payment, Clearing, and Settlement Supervision Act of 2010 (“Payment, Clearing and Settlement Supervision Act”)<sup>8</sup> to establish enhanced standards for the operation and governance of those clearing agencies registered with the Commission that meet the definition of a “covered clearing agency,” as defined by Rule 17Ad-22(a)(5)<sup>9</sup> (collectively, the new and amended rules are herein referred to as “CCA” rules). The CCA rules require that covered clearing agencies, among other things:

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<sup>5</sup> 17 CFR 240.17Ad-22.

<sup>6</sup> 17 CFR 240.17Ab2-2.

<sup>7</sup> 15 U.S.C. 78q-1.

<sup>8</sup> 12 U.S.C. 5461 et. seq.

<sup>9</sup> 17 CFR 240.17Ad-22(a)(5).

“[E]stablish, implement, maintain and enforce written policies and procedures reasonably designed to . . . .[m]aintain a sound risk management framework for comprehensively managing legal, credit, liquidity, operational, general business, investment, custody, and other risks that arise in or are borne by the [CCA], which...[i]ncludes plans for the recovery and orderly wind-down of the [CCA] necessitated by credit losses, liquidity shortfalls, losses from general business risk, or any other losses.”<sup>10</sup>

OCC is defined as a covered clearing agency under the CCA rules, and therefore is subject to the requirements of the CCA rules, including Rule 17Ad-22(e)(3).<sup>11</sup>

### **Proposed RWD Plan**

OCC is proposing to update, formalize and adopt its RWD Plan.<sup>12</sup> Consistent with the Commission’s guidance concerning the requirements of Rule 17Ad-22(e)(3)(ii), the purpose of the proposed RWD Plan is to (i) demonstrate that OCC has considered the scenarios which may potentially prevent it from being able to provide its “Critical Services” (defined below) as a going-concern,<sup>13</sup> (ii) provide appropriate plans for OCC’s recovery or orderly wind-down based on the results of such consideration;<sup>14</sup> and (iii)

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<sup>10</sup> 17 CFR 240.17Ad-22(e)(3)(ii).

<sup>11</sup> Id.

<sup>12</sup> OCC maintains a recovery and orderly wind-down plan that was prepared in response to evolving international standards for CCPs. The existing version of OCC’s recovery and orderly wind-down plan was prepared in advance of the adoption of the CCA rules.

<sup>13</sup> As defined by Rule 17Ad-22(e)(3)(ii), those scenarios are: “credit losses, liquidity shortfalls, losses from general business risks and other losses.” 17 CFR 240.17Ad-22(e)(3)(ii).

<sup>14</sup> See Standards for Covered Clearing Agencies, 81 Fed. Reg. 70786, 70810 (Oct. 13, 2016).

impart to relevant authorities the information reasonably anticipated to be necessary for purposes of recovery and orderly wind-down planning.<sup>15</sup>

As discussed in greater detail below, in preparing the proposed Plan, OCC was informed by relevant guidance from not only from OCC's regulators, but also from certain international organizations. Within the framework of this guidance, OCC has drafted the proposed Plan to reflect OCC's specific characteristics, including its ownership, organizational, and operational structures, as well as OCC's size and systemic importance relative to the products that its clears.<sup>16</sup>

The proposed RWD Plan consists of eight chapters. A description of each of the first seven chapters of the proposed Plan is provided below (Chapter 8 of the proposed plan consists of a series of appendices containing supporting material).

#### Chapter 1: Executive Summary

Chapter 1 of the RWD Plan would provide an executive summary and overview of the proposed Plan. Chapter 1 would begin by acknowledging OCC's status as a designated Systemically Important Financial Market Utility ("SIFMU")<sup>17</sup> and would recognize that the proposed Plan is designed to satisfy OCC's regulatory requirements under Rule 17Ad-22(e)(3)(ii). Chapter 1 would include a list of relevant guidance that was considered by OCC in drafting the proposed Plan; the guidance considered by OCC includes, but is not limited to, the materials listed below:

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<sup>15</sup> Id.

<sup>16</sup> See 81 Fed. Reg. at 70808.

<sup>17</sup> The Financial Stability Oversight Council designated OCC a SIFMU on July 18, 2012 pursuant to the Payment, Clearing and Settlement Supervision Act. See 12 U.S.C. 5463.

- The sections of the preamble to the Commission’s adopting release for its CCA rules that address topics relating to recovery and orderly wind-down of a CCA;<sup>18</sup>
- *Principles for Financial Market Infrastructures* (“PFMI”), published by the Bank for International Settlements Committee on Payment and Settlement Services and the Board of the International Organization of Securities Commissions (“CPSS–IOSCO”);<sup>19</sup>
- *Recovery and Resolution Planning for Systemically Important Financial Institutions: Guidance on Identification of Critical Functions and Critical Shared Services*, published by the Financial Stability Board (“FSB”);<sup>20</sup>
- *Recovery of Financial Market Infrastructures*, published by the Bank for International Settlements Committee on Payments and Market Infrastructures and the Board of the International Organization of Securities Commissions (“CPMI–IOSCO”);<sup>21</sup>
- Commodity Futures Trading Commission (“CFTC”) Staff Letter 16-61,

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<sup>18</sup> See 81 Fed. Reg. 70786.

<sup>19</sup> CPSS–IOSCO, Principles for financial market infrastructures (Apr. 16, 2012), available at <http://www.bis.org/publ/cpss101a.pdf>.

<sup>20</sup> FSB, Recovery and Resolution Planning for Systemically Important Financial Institutions: Guidance on Identification of Critical Functions and Critical Shared Services

<sup>21</sup> CPMI–IOSCO, Recovery of financial market infrastructures (published as revised on July 5, 2017), available at: <http://www.bis.org/cpmi/publ/d162.pdf> (“Recovery Report”).

published by the Division of Clearing and Risk of the CFTC;<sup>22</sup>

- *Essential Aspects of CCP Resolution Planning*, published by the FSB;<sup>23</sup>
- *Guidance on Central Counterparty Resolution and Resolution Planning*, published by the FSB;<sup>24</sup> and
- *Resilience of Central Counterparties: Further Guidance on the PFMI*, published by CPMI–IOSCO.<sup>25</sup>

Chapter 1 would highlight OCC’s designated Critical Services and would summarize the approach OCC used in preparing its “Stress Scenarios,” which are six detailed storyline scenarios that address OCC’s possible response to one or more of the following stresses: individual Clearing Member default, multiple successive Clearing Member defaults, disruption or failure of a bank or liquidity facility provider, inability to access another financial market infrastructure and general business and operational risks. The Stress Scenarios would be included in Appendix H of the Plan. Chapter 1 would restate each of the five qualitative “Recovery Trigger Events” that are identified in Chapter 5 of the RWD Plan (which constitutes OCC’s “Recovery Plan”) and explain that the timeframe for OCC’s recovery, based on the Stress Scenarios, could range from

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<sup>22</sup> CFTC Staff Letter 16-61, available at: <http://www.cftc.gov/idc/groups/public/@llettergeneral/documents/letter/16-61.pdf>.

<sup>23</sup> FSB, *Essential Aspects of CCP Resolution Planning*, (Aug. 16, 2016), available at: <http://www.fsb.org/wp-content/uploads/Essential-Aspects-of-CCP-Resolution-Planning.pdf>.

<sup>24</sup> FSB, *Guidance on Central Counterparty Resolution and Resolution Planning*, (July 5, 2017), available at: <http://www.fsb.org/wp-content/uploads/P050717-1.pdf>. (“CCP Resolution Report”).

<sup>25</sup> CPMI–IOSCO, *Resilience of central counterparties: further guidance on the PFMI* (published on July 5, 2017), available at: <http://www.bis.org/cpmi/publ/d163.pdf>.

intraday to several months. Chapter 1 also would restate each of the six qualitative “W[ind -]D[own ]P[lan] Trigger Events,” which, if occurring during OCC’s recovery efforts, could likely jeopardize the viability of OCC’s recovery and signal that initiation of OCC’s Wind-Down Plan (“WDP”) should be considered. Chapter 1 would explain that, given OCC’s critical role as the sole clearing organization for all securities options exchanges in the U.S., OCC would seek to focus primarily on recovering from any severe stress scenario; however, in the extremely remote circumstance that that OCC experienced a stress severe enough to initiate the WDP, the ultimate goal of OCC’s resolution would be to transfer ownership of OCC itself by the consummation of a consensual sale or similar transaction, in a manner ensuring the ongoing provision of OCC’s Critical Services. Chapter 1 would conclude by summarizing OCC’s assumptions for the duration of its resolution process and the estimated amount of operating capital needed to fund OCC’s resolution.

## Chapter 2: OCC Overview

Chapter 2 of the proposed RWD Plan is designed to impart information that OCC believes would be essential to relevant authorities for purposes of recovery and orderly wind-down planning, as well as to provide readers of the Plan with necessary context for the subsequent discussion and analysis of OCC’s “Critical Services” and “Critical Support Functions” in Chapter 4 (discussed below) and of OCC’s resolution process in Chapter 6 (discussed below). To accomplish this, Chapter 2 would provide a detailed description of OCC’s business, summarizing the role that OCC plays in the options market and the services and products it provides to its clearing members and market participants. Chapter 2 also would describe the regulatory oversight to which OCC is

subject, and give details on the basic structure and organization of OCC’s Board of Directors and management. Chapter 2 also would provide OCC’s financial statements and summarize the services OCC provides to its clearing members and other financial market utilities (“FMUs”). Chapter 2 would include details about OCC’s internal and external interconnectedness, distinguishing as appropriate between financial, operational and external forms of interconnectedness. Chapter 2 would further provide an explanation of each of OCC’s three lines of defense, which are employed to mitigate the various risks to which OCC is exposed,<sup>26</sup> and the internal controls framework used to implement OCC’s three lines of defense model. Chapter 2 would also discuss the participation and role of OCC’s internal Management Committee and the Board of Directors and its various committees in OCC’s risk management process. Finally, Chapter 2 would provide a discussion of OCC’s budgeting process, pricing decisions, refund pricing, retirement plan obligations, other material financial obligations and sources of funds relevant to OCC’s critical operations.<sup>27</sup>

### Chapter 3: Support Functions

In Chapter 3 of the proposed RWD Plan, OCC would identify each of its fourteen different internal support functions and provide a brief description of the activities performed by each such support function. Together, Chapters 2 and 3 of the proposed

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<sup>26</sup> The three lines of defense are discussed in greater detail in a proposed rule change regarding OCC’s “Risk Management Framework.” See Securities Exchange Act Release No. 34-81909 (Oct. 19, 2017), 82 FR 49456 (Oct. 25, 2017) (SR-OCC-2017-005).

<sup>27</sup> Each of the items listed is discussed in the “Subsequent Events” section of OCC’s 2016 Annual Report, available at: <https://www.theocc.com/components/docs/about/annual-reports/occ-2016-annual-report.pdf>.

Plan are designed to provide foundational information about the organization and operation of OCC that might be essential to relevant authorities in the event of an orderly wind-down planning. Like Chapter 2, the information provided in Chapter 3 also would provide readers of the RWD Plan with necessary context for the subsequent discussion and analysis in Chapters 4 and 6.

#### Chapter 4: Critical Services and Critical Support Functions

The primary purpose of Chapter 4 of the proposed RWD Plan would be to identify OCC’s “Critical Services” and “Critical Support Functions.” A “Critical Service,” as defined in the proposed Plan, is a service provided by OCC that, if interrupted, would likely have a material negative impact on participants or significant third parties, give rise to contagion, or undermine the general confidence of markets the FMU serves.<sup>28</sup> Similarly, a “Critical Support Function,” as defined in the proposed Plan, is a function within OCC that must continue in some capacity in order for OCC to be able to continue providing its Critical Services.

Chapter 4 of the proposed Plan sets forth the framework that OCC has used to designate its “Critical Services” and provides the analysis that OCC employed such designation. As proposed, the framework for designating OCC’s “Critical Services” enlists the following criteria to determine if failure or discontinuation of a particular its services would adversely impact financial and operational capabilities of OCC’s clearing members, other FMUs, and/or the broader financial system:

- Market Dominance: This criterion considers OCC’s market share in the relevant service and evaluation of importance of relevant service to clearing

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<sup>28</sup> See Recovery Report, p. 8.

members and to the overall economy.

- *Substitutability*: This criterion considers the existence of service providers other than OCC that could replicate the functionality of OCC’s Critical Service if such Critical Service failed or was discontinued and the ability to transfer customers and transactions to other providers in a short timeframe.
- *Interconnectedness*: This criterion considers the depth and breadth of connections between OCC and other market participants that increase the likelihood of contagion if the service failed or was discontinued.
- *Barriers to Entry*: This criterion considers the business, structural, and/or operational complexity of OCC’s services that may increase barriers to entry to other service providers.<sup>29</sup>

In proposed Chapter 4, OCC further reduces each criterion to between one and three “measurable indicators.” Each measurable indicator is assigned a “high,” “medium” or “low” rating relative to each of the services evaluated, and each rating assigned to a measurable indicator is given equal weight in OCC’s designation analysis. OCC evaluated eight discreet services, five of which were assigned a “high” rating for at least one of the measurable indicators in each of the four selected criteria. In proposed Chapter 4, certain qualitative and quantitative characteristics of each of those five discreet services is further discussed in order to reach a conclusion about the service’s criticality. In proposed Chapter 4, OCC designates several of its services as Critical

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<sup>29</sup> The criteria OCC selected align with criteria set forth in the Recovery Report to identify services as “critical” based upon “the importance to the service to the FMI’s participants and other FMIs, and to the smooth functioning of the markets the FMI serves and, in particular, the maintenance of financial stability.” See Recovery Report, p. 8.

Services on the basis of this final discussion; the services designated as Critical Services would include, but not be limited to, clearance services for listed options and clearance services for futures.

Proposed Chapter 4 derives OCC's Critical Support Functions from the Critical Services designations. In proposed Chapter 4, OCC inventories each of the fourteen support functions discussed in Chapter 3 and determines which are minimally necessary for the continued and orderly operation each of the services identified as Critical Services. On the basis of this identification process, proposed Chapter 4 identifies the eleven support functions as "Critical Support Functions."

The final sections of Chapter 4 would discuss the critical vendors for each of the Critical Support Functions, as well as the critical external interconnections that OCC maintains with other FMUs, exchanges (including designated contract markets), clearing and settlement banks, custodian banks, letter of credit banks, clearing members and credit facility lenders. These sections would be supported by the materials in Appendix B (which identifies OCC's clearing members), Appendix C (which identifies OCC's settlement banks), Appendix D (which identifies OCC's custodial banks), Appendix E (which identifies OCC's letter of credit banks), Appendix F (which identifies OCC's key vendors and service providers) and Appendix G (which identifies key agreements to be maintained).

#### Chapter 5: Recovery Plan

Chapter 5 of OCC's proposed Plan would constitute OCC's Recovery Plan. Consistent with the above-stated purpose of a recovery and orderly wind-down plan, the purpose of Chapter 5 would be to demonstrate that OCC has considered scenarios which

may potentially prevent it from being able to provide its Critical Services as a going-concern and that, based on the scenarios considered, OCC has prepared appropriate plans for its recovery.<sup>30</sup>

The Recovery Plan would begin by describing the approach OCC initially took in developing the stress scenarios and recovery scenarios in OCC's existing orderly recovery and wind-down plan. Proposed Chapter 5 would then describe the approach OCC took in refining existing scenarios and adding new scenarios to arrive at the six storyline Stress Scenarios in Appendix H of the proposed RWD Plan.<sup>31</sup>

The Recovery Plan would next identify and discuss each of OCC's "Enhanced Risk Management Tools" and "Recovery Tools," which together would form the tool set that OCC could deploy, as applicable facts and circumstances might warrant, in a stress scenario. With respect to the Enhanced Risk Management Tools and Recovery Tools, the Recovery Plan would provide an overview of the tool, and as appropriate for each tool, the Recovery Plan would include a discussion of the implementation of the tool (including the estimated time frame for implementation of the tool), the key risks

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<sup>30</sup> For the purposes of the RWD Plan, OCC would define "recovery" consistent with the definition advanced by CPMI-IOSCO, which is "the actions of an FMI, consistent with its rules, procedures, and other ex-ante contractual arrangements, to address any uncovered credit loss, liquidity shortfall, capital inadequacy, or business, operational or other structural weakness, including the replenishment of any depleted pre-funded financial resources and liquidity arrangements, as necessary to maintain the FMI's viability as a going concern." See Recovery Report, p. 3.

<sup>31</sup> As stated above, the Stress Scenarios are six detailed storyline scenarios that address OCC's possible response to one or more of the following stresses: individual Clearing Member default, multiple successive Clearing Member defaults, disruption or failure of a bank or liquidity facility provider, inability to access another financial market infrastructure and general business and operational risks.

associated with the tool, and the expected impact and incentives associated with use of the tool.

### **Enhanced Risk Management Tools**

Proposed Chapter 5 would explain that OCC's Enhanced Risk Management Tools are designed to supplement OCC's existing processes and other existing tools in scenarios where OCC faces heightened stresses. Contrary to the Recovery Tools (which are described in greater detail below), the use of OCC's Enhanced Risk Management Tools would not be intended to be limited strictly to situations in which a Recovery Trigger Event has occurred. Rather, OCC's Enhanced Risk Management Tools have been designed such that they could be used prior to the occurrence of a Recovery Trigger Event (and preferably, the Enhanced Risk Management Tools would be used prophylactically in an effort to prevent the occurrence of a Recovery Trigger Event). As proposed, OCC would not anticipate there being a rigid order or timing for the deployment of its Enhanced Risk Management Tools, subject to one caveat – "Cash Settlement of Physically Delivered Options and Single Stock Futures" would only be deployed in very narrow circumstances where a correspondent clearing organization has rejected the settlement obligations of an OCC Clearing Member and OCC does not believe it has sufficient liquid resources immediately available to facilitate settlement through a substitute broker.

Descriptions of each of the Enhanced Risk Management Tools contained in the proposed Recovery Plan are provided below:

Use of Current/Retained Earnings. Section 5(d) of Article VIII of OCC's By-Laws provides OCC with the authority to use current and/or retained earnings to

discharge a loss that would be chargeable against the Clearing Fund. The Recovery Plan would identify this existing authority as one of OCC's Enhanced Risk Management Tools.

As stated in Section 5(d) of Article VIII of the By-Laws, use of OCC's current and/or retained earnings would require prior unanimous consent from the holders of OCC's Class A common stock and Class B common stock. Accordingly, the Recovery Plan would acknowledge that the utility of this particular tool is limited by the fact that the tool is dependent upon receipt of unanimous consent from OCC's existing stockholders (and therefore, the availability of the tool cannot be known in advance). The Recovery Plan would further acknowledge that because OCC's retained earnings presently amount to only a small fraction of OCC's existing prefunded Clearing Fund resources, the maximum utility of this particular tool may be realized in specific circumstances at either the beginning of OCC's loss waterfall (i.e., by attempting to fully extinguish the liabilities and obligations arising from a Clearing Member's default without charging the Clearing Fund whatsoever) or toward the end of OCC's loss waterfall (i.e., by attempting to contribute additional resources that may be necessary for OCC to fully extinguish its liabilities and obligations through tear-up).

Minimum Clearing Fund Cash Contribution. OCC is in the process of proposing a requirement that Clearing Members collectively contribute \$3 billion in cash to the Clearing Fund and that OCC would have discretionary authority, in certain limited circumstances, to increase that minimum cash requirement from \$3 billion up to the then-

minimum size of the Clearing Fund. (“Cash Clearing Fund Requirement”).<sup>32</sup> The Cash Clearing Fund Requirement would be included in the Recovery Plan as one of OCC’s Enhanced Risk Management Tools.

With respect to OCC’s discretionary authority to increase the minimum cash requirement, the proposal would allow OCC’s Executive Chairman, Chief Administrative Officer (“CAO”), or Chief Operating Officer (“COO”), upon providing notice to the Risk Committee of OCC’s Board of Directors (“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 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 proposal would require that any such temporary increase be reviewed by the Risk Committee as soon as practicable, but in any event within 20 calendar days of the increase. Clearing Members would be required to satisfy any such increase in their required cash contributions no later than one hour before the close of the Fedwire (i.e., 5:30 p.m. Central Time) on the business day following OCC’s issuance of an instruction to increase cash contributions.

OCC’s Recovery Plan would acknowledge that the process for initiating any increase to the minimum cash requirement would be driven by the preparation of a “Close-Out Action Plan,” which is an internal document prepared in accordance with

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<sup>32</sup> See Securities Exchange Act Release No. 34-82156 (Nov. 27, 2017), 82 FR 57015 (Dec. 1, 2017) (SR-OCC-2017-019).

OCC's Default Management Policy and Default Management Procedures that, among other things, takes into consideration the projected liquidity demands for successful management of a defaulted Clearing Member. The Recovery Plan recognizes that the expected impact of any increase to the minimum Clearing fund cash requirement could be the exacerbation of any ongoing liquidity constraints facing OCC's Clearing Members.

*Borrowing Against Clearing Fund.* 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>33</sup> OCC has proposed to extend this borrowing authority to include a third scenario, whereby OCC could borrow (or otherwise obtain funds through any means determined to be reasonable by the Executive Chairman, COO or CAO) 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.<sup>34</sup> This borrowing authority, as expanded by the proposed rule change, would be included in the Recovery Plan as one of OCC’s Enhanced Risk Management Tools.

The Recovery Plan would acknowledge that the process for initiating any borrowing against the Clearing Fund would be driven by the preparation of a “Close-Out Action Plan” (in the event of a Clearing Member default), in accordance with the execution of OCC’s “Settlement Bank Failure Procedure” (in the event of a disruption to or failure of a settlement bank), in accordance with the execution of OCC’s “Linked FMI Disruption Procedure” (in the event of a disruption to a linked financial market infrastructure). The Recovery Plan would further acknowledge that a borrowing pursuant to a recommendation in a Close-Out Action Plan or under either of the Settlement Bank Failure Procedures or Linked FMI Disruption Procedures would occur in accordance with

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<sup>33</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.

<sup>34</sup> OCC has filed a proposed rule change with the Commission in connection with the authority to borrow against the Clearing Fund to address liquidity needs for same-day settlement. See Securities Exchange Act Release No. 34-81058 (Jun. 30, 2017), 82 FR 31371 (July 6, 2017) (SR-OCC-2017-803).

OCC’s “Syndicated Credit Facility Procedure.” The Recovery Plan recognizes that a key risk of this particular tool would be that in a heightened stress scenario OCC’s primary liquidity facilities already may be fully or partially utilized (and therefore, the availability of the tool cannot be known in advance).

OCC’s Credit Facility. OCC maintains a \$2.0 billion senior secured 364-day revolving credit facility with a syndicate of lenders.<sup>35</sup> The purpose of the facility is to provide OCC with liquidity to meet settlement obligations as a central counterparty. The Recovery Plan would include the facility among OCC’s Enhanced Risk Management Tools.

The Recovery Plan would recognize that borrowings under the facility would occur in accordance with OCC’s Syndicated Credit Facility Procedure. The Recovery Plan would further recognize that the key risk associated with the use of the facility is that a portion of the syndicate may not timely fund OCC’s draw.

OCC’s Non-Bank Facility. OCC maintains a \$1.0 billion secured non-bank liquidity facility.<sup>36</sup> The purpose of the non-bank facility is to provide OCC with a non-bank liquidity resource to meet settlement obligations as a central counterparty. The Recovery Plan would include the non-bank facility among OCC’s Enhanced Risk Management Tools.

The Recovery Plan would recognize that borrowings under the facility would occur in accordance with OCC’s “Non-Bank Facility Procedure.” The Recovery Plan

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<sup>35</sup> See Securities Exchange Act Release No. 34-81956 (Oct. 26, 2017) (SR-OCC-2017-017).

<sup>36</sup> See Securities Exchange Act Release No. 34-76821 (Jan 4, 2016), 81 FR 3208 (Jan. 4, 2016) (SR-OCC-2016-805).

would further recognize that the key risk associated with the use of the non-bank facility is that OCC's counterparty may not timely execute the transaction.

Cash Settlement of Physically Delivered Options and Single Stock Futures. OCC is in the process of proposing a new Rule 913,<sup>37</sup> which would provide OCC the ability to require cash settlement of otherwise physically-settled delivery obligations arising from exercised or assigned stock options and/or physically-settled matured stock futures in the event that a correspondent clearing corporation<sup>38</sup> rejects the settlement obligations for such stock options and/or stock futures (such rejected stock options and/or stock futures hereinafter, "Rejected Cleared Securities") and either of the two following necessary conditions exists: (i) the liquidity demand on OCC to fund an alternative form of settlement for such Rejected Cleared Securities (*i.e.*, settlement through the use of a "substitute broker")<sup>39</sup> would exceed the amount of liquid resources immediately available to OCC, or (ii) no agent is available to serve as substitute broker to facilitate alternative settlement for OCC.<sup>40</sup> In these extremely limited circumstances, fixing cash settlement

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<sup>37</sup> OCC will be filing a proposed rule change with the Commission in connection with this proposal. See SR-OCC-2017-018.

<sup>38</sup> Under Article I of OCC's By-Laws, the term "correspondent clearing corporation" means the National Securities Clearing Corporation or any successor thereto which, by agreement with the OCC, provides facilities for settlements in respect of exercised option contracts or BOUNDS or in respect of delivery obligations arising from physically-settled stock futures.

<sup>39</sup> "Substitute broker" refers to the use of another OCC clearing member that remains in good standing at the correspondent clearing corporation and that, on OCC's behalf, will facilitate settlement of OCC's delivery obligations of the Rejected Cleared Securities through the correspondent clearing corporation.

<sup>40</sup> To avoid the retroactive application of Rule 913, OCC's ability to require cash settlement of cleared securities would only apply where the relevant cleared securities were issued by OCC after regulatory approval is received for this

amounts pursuant to proposed Rule 913 would provide OCC with the ability to substantially reduce the liquidity demands that it might otherwise face if required to fund an alternative form of settlement to effect physical delivery. The Recovery Plan would include cash settlement of otherwise physically-delivered options and single-stock futures pursuant to proposed Rule 913 among OCC’s Enhanced Risk Management Tools.

The Recovery Plan would acknowledge that, assuming one of the two necessary conditions exists, the process for initiating cash settlement would be driven by the preparation of a “Close-Out Action Plan,” which would recommend impacted options and single-stock futures be cash settled in lieu of physical delivery. The Recovery Plan would also acknowledge that execution of cash settlement would occur in accordance with OCC’s “Alternative Cash Settlement of Cleared Contracts Procedure.” The Recovery Plan recognizes that a key risk of this particular tool would be the potentially detrimental impacts on Clearing Members and their customers, who would receive a cash settlement amount when they had anticipated receiving physical securities.

### **Recovery Tools**

Proposed Chapter 5 would explain that OCC’s Recovery Tools differ from OCC’s Enhanced Risk Management Tools in that the use of each Recovery Tool is generally limited to a scenario in which a Recovery Trigger Event has occurred, and as discussed below, the sequence and timing of the deployment of each Recovery Tool is more structured than the sequence and timing for the deployment of the Enhanced Risk

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proposed rule change and the change has been implemented by OCC. As of the date of this filing, OCC lists standard equity options through November 25, 2024 and flexible style equity options through December 18, 2026.

Management Tools. As noted below, each of the Recovery Tools is discussed in greater detail in a proposed rule change that has been filed with the Commission.

Descriptions of each of the Recovery Tools contained in the proposed Recovery Plan are provided below:

Assessment Powers. OCC is in the process of amending its By-Laws to revise its assessment powers such that OCC would have the authority to assess non-defaulting Clearing Members during any “cooling-off period” (explained below) in an aggregate amount equal to 200% of each such Clearing Member’s required contribution as of the time immediately preceding the start of the applicable cooling-off period (hereinafter, “Assessment Powers”).<sup>41</sup> Under the proposed Assessment Powers, an automatic minimum fifteen calendar day cooling-off period would begin whenever a proportionate charge is assessed by OCC against Clearing Members’ Clearing Fund contributions. While the cooling-off period would continue for a minimum of fifteen consecutive calendar days, if one or more of the events described in clauses (i) through (iv) of Article VIII, Section 5(a) of OCC’s By-Laws occur(s) during that fifteen calendar day period and result(s) in one or more proportionate charges against the Clearing Fund, the cooling-off period would be extended through either (i) the fifteenth calendar day from the date of the most recent proportionate charge resulting from the subsequent event, or (i) the twentieth day from the date of the proportionate charge that initiated the cooling-off period, whichever is sooner. During such cooling-off period, the proposed Assessment Powers would cap each Clearing Member’s aggregate liability to replenish the Clearing Fund at 200% of the Clearing Member’s then-required contribution to the Clearing Fund.

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<sup>41</sup> OCC has filed a proposed rule change with the Commission in connection with this proposal. See SR-OCC-2017-020.

Once the cooling-off period ends each remaining Clearing Member would be required to replenish the Clearing Fund in the amount necessary to meet its then-required contribution.<sup>42</sup> The Recovery Plan would include the proposed Assessment Powers among OCC's Recovery Tools.

The Recovery Plan would discuss the mechanics for replenishment of the Clearing Fund, which is the mechanism by which assessments would be collected from Clearing Members.<sup>43</sup> The Recovery Plan would acknowledge that one of the key risks associated with OCC's assessment powers is that utilization of assessment powers (or even prefunded Clearing Fund resources) may incentivize Clearing Members to withdraw from membership (to avoid replenishing the Clearing Fund following the cooling-off

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<sup>42</sup> Under the proposed Assessment Powers, the time frame within which a Clearing Member may provide a termination notice to OCC to avoid liability for replenishment of the Clearing Fund after the cooling-off period would be extended and the obligations of such a terminating Clearing Member for closing-out and transferring its remaining open positions would be modified. Specifically, to effectively terminate its status as a Clearing Member and not be liable replenishing the Clearing Fund after the cooling-off period, a Clearing Member would be required to: (i) notify OCC in writing of its intent to terminate not later than the last day of the cooling-off period, (ii) not initiate any opening purchase or opening writing transaction, and, if the Clearing Member is a Market Loan Clearing Member or a Hedge Clearing Member, not initiate any Stock Loan transaction, through any of its accounts, and (iii) close-out or transfer all of its open positions by no later than the last day of the cooling-off period. If a Clearing Member failed to satisfy all of these conditions by the end of a given cooling-off period, it would not have completed all of the requirements necessary to terminate its status as a Clearing Member and therefore it would remain subject to the obligation to replenish the Clearing Fund after the end of the cooling-off period.

<sup>43</sup> Article 6 of OCC's By-Laws states that Clearing Members are required to promptly make good any deficiency in their required contribution that results from a charge against the Clearing Fund, and Clearing Members must make good any such deficiencies by 9:00 a.m. Central Time on the first business day following the day on which OCC notifies Clearing Members of such deficiency.

period), thereby potentially reducing the size of the future Clearing Fund as well as OCC's future assessment powers.

Voluntary Payments. OCC is in the process of proposing new Rule 1009, which would provide a framework by which OCC could receive voluntary payments in a circumstance where a Clearing Member has defaulted and OCC has determined that, notwithstanding the availability of any remaining resources under OCC Rules 707, 1001, 1104 through 1107, 2210 and 2211,<sup>44</sup> OCC may not have sufficient resources to satisfy its obligations and liabilities resulting from such default.<sup>45</sup> Under proposed Rule 1009, non-defaulting Clearing Members would be invited to make voluntary payments to the Clearing Fund, in addition to any amounts they are otherwise required to contribute. If OCC subsequently recovers from the estate(s) of the defaulted Clearing Member(s), all non-defaulting Clearing Members that made voluntary payments would be repaid from such recovery (and if the amount recovered the defaulted Clearing Member(s) is less than the aggregate amount of voluntary payments, non-defaulting Clearing Members that made voluntary payments each would receive a percentage of the recovery that corresponds to that Clearing Member's percentage of the total amount of voluntary payments received). The Recovery Plan would include proposed Rule 1009 among OCC's Recovery Tools.

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<sup>44</sup> Rule 707 addresses the treatment of funds in a Clearing Member's X-M accounts. Rule 1001 addresses the size of OCC's Clearing Fund and the amount of a Clearing Member's contribution. Rules 1104 through 1107 concern the treatment of the portfolio of a defaulted Clearing Member. Rules 2210 and 2211 concern the treatment of Stock Loan positions of a defaulted Clearing Member.

<sup>45</sup> OCC has filed a proposed rule change with the Commission in connection with this proposal. See SR-OCC-2017-020.

The Recovery Plan would discuss the mechanics for voluntary payments and the estimated time frame for issuing a “Voluntary Payment Notice” and collecting voluntary payments (from several hours to overnight, depending on the timing of the event driving OCC’s determination to call for voluntary payments).<sup>46</sup> The Recovery Plan would acknowledge that the key risk associated with the ability to call for voluntary payments is that non-defaulting Clearing Members would be unwilling, or unable, to participate.

Voluntary Tear-Up. OCC is in the process of proposing new Rule 1111, which, in relevant part, would establish a framework by which non-defaulting Clearing Members and non-defaulting customers of Clearing Members could be given an opportunity to voluntarily extinguish (i.e., voluntarily tear-up) their open positions at OCC in a circumstance where a Clearing Member has defaulted and OCC has determined that, notwithstanding the availability of any remaining resources under OCC Rules 707, 1001, 1104 through 1107, 2210 and 2211, OCC may not have sufficient resources to satisfy its obligations and liabilities resulting from such default.<sup>47</sup> OCC presumes that the scope of any voluntary tear-up would be dictated by the cleared contracts remaining in the portfolio(s) of the defaulted Clearing Member(s); however, to ensure OCC retains sufficient flexibility to effectively deploy this tool in an extreme stress event, proposed Rule 1111(c) would provide the Risk Committee with discretion to determine the appropriate scope of each voluntary tear-up. New Rule 1111(c) also would impose

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<sup>46</sup> Article 6 of OCC’s By-Laws states that Clearing Members are required to promptly make good any deficiency in their required contribution that results from a charge against the Clearing Fund, and Clearing Members must make good any such deficiencies by 9:00 a.m. Central Time on the first business day following the day on which OCC notifies Clearing Members of such deficiency.

<sup>47</sup> OCC has filed a proposed rule change with the Commission in connection with this proposal. See SR-OCC-2017-020.

standards designed to circumscribe the Risk Committee’s discretion, requiring that any determination regarding the scope of a voluntary tear-up would (i) be based on 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 Recovery Plan would include this proposed authority to call for voluntary tear-ups among OCC’s Recovery Tools.

The Recovery Plan anticipates that OCC’s tear-up process – for both voluntary tear-ups as well as partial tear-ups – would be initiated on a date sufficiently in advance of the exhaustion of OCC’s financial resources such that OCC would be expected to have adequate remaining resources to cover the amount it must pay to extinguish the positions of Clearing Members and customers without haircutting gains.<sup>48</sup> The Recovery Plan contemplates that, if tear-up becomes necessary, OCC likely would initiate its tear-up process after the market closes on the date on which OCC has determined that the amount of its remaining financial resources measured against the estimated stressed exposure of the unauctioned positions in the portfolio(s) of the defaulted Clearing Member(s)

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<sup>48</sup> OCC is not proposing a tear-up process that would require the imposition of “gains haircutting” (*i.e.*, the reduction of unpaid gains) on a portion of OCC’s cleared contracts. In general, OCC believes that forced gains haircutting is a tool that can be more easily applied to products whose gains are settled at least daily, like futures through an exchange of variation margin, and by central counterparties with comparatively large daily settlement flows. Listed options, which constitute the vast majority of the contracts cleared by OCC, do not have daily settlement flows and any attempt to reduce the “unrealized gains” of a listed options contract would require the reduction of the option premium that is embedded within the required margin (such a process would effectively require haircutting the listed option’s initial margin). In OCC’s proposed tear-up process, the holders of torn-up positions would be assigned a Tear-Up Price and OCC would draw on its remaining financial resources in order to extinguish the torn-up positions at the assigned Tear-Up Price without forcing a reduction in the amount unpaid gains on such positions.

warrants the initiation of OCC's tear-up process (for purposes of this example, Day T). The Recovery Plan anticipates that notice of tear-up (both voluntary tear-up and partial tear-up) would be published no later than the morning of the following trading day prior to the market opening (for purposes of this example, Day T+1) and that the call for voluntary tear-ups would remain open throughout the duration of the trading on Day T+1. The Recovery Plan anticipates that voluntarily tendered positions would be extinguished either after the close on Day T+1 or prior to the opening of the markets on Day T+2 (where Day T+2 is a trading day), and that such positions would be extinguished at their last established end-of-day settlement price, in accordance with OCC's existing practices concerning pricing and valuation (i.e., the closing price on Day T+1).

After OCC has completed its tear-up process and re-established a matched book, OCC expects that holders of both voluntarily torn-up and mandatorily torn-up positions would be provided with a limited opportunity to re-establish positions in the contracts that were voluntarily or mandatorily extinguished. For the losses, costs or expenses imposed upon the holders of torn-up positions, proposed Rule 1111 would provide OCC with two separate and non-exclusive means of equitably re-allocating such losses costs or expenses.<sup>49</sup>

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<sup>49</sup> Proposed Rule 1111 would provide OCC discretion to use remaining Clearing Fund contributions to re-allocate losses imposed on non-defaulting Clearing Members and customers from such tear-up(s). Further, proposed Rule 1111(a) also would provide that if OCC subsequently recovers from the estate(s) of the defaulted Clearing Member(s) and the amount of such recovery exceeds the amount OCC received in voluntary payments, then non-defaulting Clearing Members and non-defaulting customers that voluntarily tore-up open positions and incurred losses from such tear-ups would be repaid from the amount of the recovery in excess of the amount OCC received in voluntary payments (if the amount recovered is less than the aggregate amount of voluntary tear-up, each non-defaulting Clearing Member and non-defaulting customer that incurred losses

In addition to discussing the above mechanics for voluntary tear-up and the estimated time frame for initiating and completing OCC's tear-up process, the Recovery Plan would acknowledge that the key risk associated with the ability to call for voluntary tear-ups is that non-defaulting Clearing Members and nonwould be unwilling, or unable, to participate.

*Partial Tear-Up.* Proposed Rule 1111 also would provide the Board with discretion to extinguish the remaining (i.e., mandatorily extinguish) open positions of any defaulted Clearing Member or customer of such defaulted Clearing Member(s) (such positions, "remaining open positions"), as well as any related open positions as necessary to mitigate further disruptions to the markets affected by the Remaining Open Positions (such positions, "related open positions"), in a circumstance where a Clearing Member has defaulted and OCC has determined that, notwithstanding the availability of any remaining resources under OCC Rules 707, 1001, 1104 through 1107, 2210 and 2211, OCC may not have sufficient resources to satisfy its obligations and liabilities resulting from such default (such tear-ups, "partial tear-ups"). Like the determination for voluntary tear-ups, OCC presumes that the scope of any partial tear-up would be dictated by the cleared contracts remaining in the portfolio(s) of the defaulted Clearing Member(s); however, to ensure OCC retains sufficient flexibility to effectively deploy this tool in an extreme stress event, proposed Rule 111(c) would provide the Risk Committee with discretion to determine the appropriate scope for each partial tear-up. Proposed Rule 1111(c) would impose the same standards designed to circumscribe the

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from voluntarily torn-up positions would be repaid in an amount proportionate to the percentage of its total amount of losses, costs and fees imposed on Clearing Members or customers as a result of the voluntary tear-ups).

Risk Committee's discretion as would be imposed with respect to voluntary tear-ups: partial tear-ups would (i) be based on 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 Recovery Plan would include this proposed authority to impose mandatory tear-ups among OCC's Recovery Tools.

As explained above, the Recovery Plan would anticipate that the process for implementing a partial tear-up would be intertwined with the process for implementing a voluntary tear-up. The Recovery Plan would also make clear that partially torn-up positions would be allocated to non-defaulting Clearing Members' accounts (and further allocated by Clearing Members to their non-defaulting customers' accounts) on a pro rata basis.

Replenishment Capital. In 2015 OCC adopted a capital plan ("Capital Plan") under which OCC's stockholder exchanges made an additional capital contribution and, in the event that total shareholder's equity falls below a certain threshold, committed to replenishing OCC's capital up to an amount determined as OCC's "Baseline Capital Requirement."<sup>50</sup> The Recovery Plan would include the replenishment capital that OCC's stockholder exchanges would be required to provide under the Capital Plan among OCC's Recovery Tools.

In addition to generally discussing each of the Enhanced Risk Management Tools and Recovery Tools as described above, the Recovery Plan also would provide a

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<sup>50</sup> See Securities Exchange Act Release No. 34-74387 (Feb. 26, 2015), 80 FR 12215 (Mar. 6, 2015) (SR-OCC-2014-813). As stated in the advance notice, OCC's Baseline Capital Requirement for 2015 was \$117,000,000.

mapping of OCC’s Enhanced Risk Management Tools and Recovery Tools against the types of financial market infrastructure (“FMI”) risk exposures identified in the Recovery Report.<sup>51</sup> The general mapping of tools to risk exposures is presented below:

- Tools to address uncovered credit losses from a Clearing Member default: Use of current/retained earnings, proposed voluntary payments and proposed Assessment Powers.
- Tools to address liquidity shortfalls: minimum Clearing Fund cash contribution, borrowing against Clearing Fund, OCC’s credit facility, OCC’s non-bank facility and cash settlement of physically delivered options and single stock futures.
- Tools to replenish financial resources: Replenishment capital.
- Tools to address losses related to business, operational or other structural weaknesses (i.e., losses not caused by Clearing Member Default): Borrowing against Clearing Fund and replenishment capital.
- Tools to re-establish a matched book: Voluntary tear-up and partial tear-up.

The Recovery Plan would include a short discussion of how the Enhanced Risk Management Tools and Recovery Tools would apply to each of the risk categories and failure scenarios identified in the Recovery Report.<sup>52</sup> The discussion of each risk category would reference the appropriate Stress Scenarios in Appendix H that

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<sup>51</sup> The Recovery Report recognizes the following risk exposures for an FMI: legal risk, credit risk, liquidity risk, general business risk, custody risk, investment risk and operational risk. See Recovery Report, p. 12.

<sup>52</sup> The Recovery Report identifies the following purposes for an FMI’s recovery tools: (i) tools to allocate uncovered credit losses caused by a participant default, (ii) tools to address uncovered liquidity shortfalls, (iii) tools to replenish financial resources, (iv) tools for CCPs to re-establish a matched book following a participant default, and (v) tools to allocate losses not caused by participant default. See Recovery Report, p. 17.

demonstrate the use of applicable Enhanced Risk Management Tools and Recovery Tools. The Recovery Plan also would discuss the Enhanced Risk Management Tools and Recovery Tools in the context of the characteristics of recovery tools enumerated in the CPMI-IOSCO Recovery Report.<sup>53</sup>

After discussing the Enhanced Risk Management Tools and Recovery Tools, the Recovery Plan would identify five qualitative “Recovery Trigger Events” (events that – if occurring during OCC’s risk management efforts – would indicate that OCC is facing an extreme stress event that potentially threatens OCC’s viability). The Recovery Plan would specify that the occurrence of a Recovery Trigger Event shall require OCC personnel to notify the Commission and the CFTC (and the Federal Deposit Insurance Corporation, to the extent applicable), and such notice shall apprise the regulator(s) of the specific Recovery Trigger Event that has occurred and sufficient information to enable the regulator(s) to understand the nature of the occurrence of the Recovery Trigger Event. The Recovery Plan would further outline an escalation process for the occurrence of a Recovery Trigger Event. The escalation process would start with individual support function leads, who would be responsible for communicating the possible occurrence of a Recovery Trigger Event to other support functions within OCC. The escalation process would require OCC’s Enterprise Risk Management and Financial Risk Management groups to be responsible for assessing the situation and providing recommendations regarding the potential use of Enhanced Risk Management Tools and Recovery Tools. The escalation process would identify that the Chief Executive Officer and Executive

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<sup>53</sup> The Recovery Report states that a financial market infrastructure’s recovery tools should (i) be comprehensive, (ii) be effective, (ii) be transparent, measurable, manageable and controllable, (iv) create appropriate incentives, and (v) minimize negative impact. See Recovery Report, p. 13.

Chairman would be responsible for providing necessary approvals for the implementation of Enhanced Risk Management Tools and Recovery Tools, and that the Chief Risk Officer and the Management Committee would be responsible for overseeing the deployment of any Enhanced Risk Management Tools or Recovery Tools. The escalation process would identify OCC's Board and the Risk Committee of the Board as being responsible for generally overseeing OCC's recovery efforts.

Finally, the Recovery Plan would provide general descriptions of how OCC would anticipate deploying its Enhanced Risk Management and Recovery Tools in response to each of the six Stress Scenarios detailed in Appendix H. As described above, the six detailed Stress Scenarios would be grouped into the following categories of stresses: individual Clearing Member default, multiple successive Clearing Member defaults, disruption or failure of a bank or liquidity facility provider, inability to access another financial market infrastructure and general business and operational risks.

#### Chapter 6: Wind-Down Plan

Chapter 6 of OCC's proposed RWD Plan would constitute OCC's WDP. Consistent with the above-stated purpose of an orderly wind-down plan, Chapter 6 would demonstrate that OCC has considered scenarios which may potentially prevent it from being able to provide its Critical Services as a going-concern and that OCC has adequately evaluated plans for its orderly wind-down.<sup>54</sup>

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<sup>54</sup> For the purposes of the RWD Plan, OCC would frame its wind-down objective consistent with the objective advanced by the FSB for CCP resolution: "CCP resolution should have as its objective the pursuit of financial stability and ensure the continuity of critical CCP functions in all jurisdictions where those functions are critical and without exposing taxpayers to risk of loss....The objectives of CCP resolution can be achieved either by: (i) restoring the ability of the CCP to continue to perform its critical functions as a going concern; or (ii) ensuring

The WDP would state OCC’s basic assumptions concerning the resolution process, including assumptions about the duration of the resolution process, the cost of the resolution process, OCC’s capitalization through the resolution process, the maintenance of Critical Services and Critical Support Functions and the retention of personnel and contractual relationships. The WDP would further identify six “WDP Trigger Events” that – if occurring during OCC’s recovery efforts – could likely jeopardize the viability of OCC’s recovery and signal that initiation of the WDP should be considered. Upon the occurrence of any WDP Trigger Event, the WDP would require OCC personnel to notify the Commission and the CFTC (and the Federal Deposit Insurance Corporation, to the extent applicable), and such notice must apprise the regulator(s) of the specific WDP Trigger Event that has occurred and sufficient information to enable the regulator(s) to understand the nature of the occurrence of the WDP Trigger Event. Additionally, the WDP would prescribe for each WDP Trigger Event more tailored internal notification requirements. These more tailored notification requirements would designate OCC personnel in specific support functions (generally, the function whose area is most closely related to, or impacted by, the specific WDP Trigger Event) as responsible for identifying such WDP Trigger Event and for notifying OCC’s senior management.

The WDP also would reference the importance of the critical external interconnections (discussed in Chapter 4) to the resolution process and highlight the key agreements that would be necessary to maintain throughout OCC’s resolution (such

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continued performance of those functions by another entity or arrangement (including a bridge entity established by the resolution authority) coupled with the orderly wind-down of the residual CCP in resolution.” See CCP Resolution Report, p. 2.

agreements would be listed in Appendix G). The WDP would provide a discussion of the key actions that OCC (or a resolution authority) could take during the resolution process. The key actions discussed in the WDP would include the following: the decision by OCC's Board (informed by senior management) to abandon recovery and initiate OCC's resolution process; the potential institution of new or heightened requirements on clearing membership; the potential imposition of heightened capital requirements on clearing members (consistent with the existing requirements in Rule 301); the imposition of increased margin requirements for Clearing Members (pursuant to the existing authority under Rule 603); ceasing OCC's investment activities; instituting new operational practices (to address any operation weaknesses that caused, or contributed to, the events resulting in the initiation of the resolution process), and; targeted reductions in force (by each of the fourteen support functions discussed in Chapter 3).

The WDP also would identify potential transactions that could be entered to accomplish the objectives of wind-down ("WDP Transactions"), as well as discuss the possibility of ceasing operation of OCC's Critical Services. The WDP would state that the goal of OCC's resolution – and thusly of any WDP Transaction – would be to transfer ownership of OCC itself by the consummation of a consensual sale or similar transaction, in a manner that ensures the continuation of OCC's Critical Services. The WDP would examine the structure of three potential WDP Transactions, with a focus on the corporate, transactions, governance and regulatory issues relating to each structure. In order of preference based on OCC's examination, the first structure would be a "Stock Transaction," meaning a sale by OCC's stockholder exchanges of all of their shares of stock to one or more new owners; the second structure would be a "Merger Transaction,"

meaning a merger or consolidation of OCC with another entity (with the aim of OCC remaining as the surviving entity), and; the third structure would be an “Asset Transaction,” meaning that substantially all of OCC’s assets and some or all of OCC’s liabilities, including open positions in OCC-cleared contracts along with related Clearing Fund deposits and margin collateral, would be transferred to a third party.

With respect to the possibility of ceasing OCC’s Critical Services, the WDP would consider taking a corporate action to consider institution of a bankruptcy or insolvency proceeding, which would have the effect of triggering the existing close-out netting provisions in Article VI, Section 27 of OCC’s By-Laws.

#### Chapter 7: RWD Plan Governance

Chapter 7 of OCC’s proposed Plan would memorialize the prior governance for approval of the earlier drafts of OCC’s recovery and orderly wind-down plan and would establish an internal governance process for the maintenance, review and approval of the proposed RWD Plan. The internal governance process for the approval of subsequent changes to OCC’s proposed RWD Plan would initiate with an RWD Working Group, which would recommend any changes to OCC’s Management Committee. OCC’s Management Committee, in turn, would review and, as appropriate, approve and recommend any changes to OCC’s Risk Committee. OCC’s Risk Committee, in turn, would review and, as appropriate, approve and recommend any changes to OCC’s Board. OCC’s Board would have final responsibility for review and approval of subsequent changes to OCC’s proposed RWD Plan.

## 2. Statutory Basis

OCC believes that the proposed rule change is consistent with Section 17A(b)(3)(F) of the Act<sup>55</sup> because the proposed change to update and formalize OCC's RWD Plan ultimately would protect investors and the public interest. The Recovery Plan is designed to enhance OCC's ability to address extreme stresses or crises by establishing a framework that OCC could use to navigate the use its Enhanced Risk Management Tools and Recovery Tools, with the aim of maintaining OCC's viability as a going concern. In the event that OCC's recovery efforts are not successful, the WDP would seek to improve the possibility that a resolution of OCC's operations can be conducted in an orderly manner, thereby minimizing the disruption to Clearing Members and market participants and improving the likelihood of minimizing the risk of contagion to the broader financial system. Accordingly, OCC believes its proposed RWD Plan improves the possibility of maintaining market and public confidence during a time of unprecedented stress. In this regard, OCC believes the proposed rule change ultimately would protect investors and the public interest in a manner consistent with Section 17A(b)(3)(F) of the Act.<sup>56</sup>

OCC believes that the proposed rule change is also consistent with Rule 17Ad-22(e)(3)(ii).<sup>57</sup> As stated above, the RWD Plan would describe OCC's plans to recover from, or orderly resolve its operations as a result of, severe stress brought about by credit

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<sup>55</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>56</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>57</sup> 17 CFR 240.17Ad-22(e)(3)(ii).

losses, liquidity shortfalls, losses from general business risk or other losses.<sup>58</sup> Consistent with the Commission's guidance, the proposed RWD Plan would consider scenarios which may potentially prevent OCC from providing its Critical Services as a going-concern and provide appropriate plans for OCC's recovery or orderly wind-down based on the results of such considerations. Further, OCC's proposed Plan would seek to provide the information that a resolution authority may reasonably anticipate as necessary for purposes of recovery and orderly wind-down planning.<sup>59</sup> In this regard, OCC believes its proposed rule change is consistent with Rule 17Ad-22(e)(3)(ii).<sup>60</sup>

The proposed rule change is not inconsistent with the existing rules of OCC, including any other rules proposed to be amended.

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

Section 17A(b)(3)(I) of the Act<sup>61</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 proposed rule change would impact or impose any burden on competition.<sup>62</sup> The proposed rule change would update and memorialize OCC's RWD Plan. The RWD Plan would only be used in extreme stress scenarios, and the Plan is designed to be used only internally (or by a resolution authority). The proposed rule change would not affect Clearing Members' access to OCC's services or impose any direct burdens on Clearing Members. Accordingly, the

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<sup>58</sup> 17 CFR 240.17Ad-22(e)(3)(ii).

<sup>59</sup> See 81 Fed. Reg. at 70810.

<sup>60</sup> 17 CFR 240.17Ad-22(e)(3)(ii).

<sup>61</sup> 15 U.S.C. 78q-1(b)(3)(I).

<sup>62</sup> 15 U.S.C. 78q-1(b)(3)(I).

proposed rule change would not unfairly inhibit access to OCC's services or disadvantage or favor any particular user in relationship to another user.

For the foregoing reasons, OCC believes that the proposed rule change is in the public interest, would be consistent with the requirements of the Act applicable to clearing agencies, and would not impact or impose a burden on competition.

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-2017-021 on the subject line.

Paper Comments:

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

All submissions should refer to File Number SR-OCC-2017-021. 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, N.E., 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/components/docs/legal/rules\\_and\\_bylaws/sr\\_occ\\_17\\_021.pdf](https://www.theocc.com/components/docs/legal/rules_and_bylaws/sr_occ_17_021.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-2017-021 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>63</sup>

Eduardo A. Aleman  
Assistant Secretary

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<sup>63</sup> 17 CFR 200.30-3(a)(12).