

notice of the grounds for possible disapproval under consideration. The Commission is instituting proceedings to allow for additional analysis of the proposed rule change's consistency with Section 6(b)(5) of the Act,<sup>23</sup> which requires, among other things, that the rules of a national securities exchange be "designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade," and "to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest."<sup>24</sup> The Commission believes that several of the proposed rule changes are not consistent with the CAT NMS Plan or exemptive relief that has been granted as of the date of this Order.

#### IV. Commission's Solicitation of Comments

The Commission requests that interested persons provide written submissions of their views, data, and arguments with respect to the issues identified above, as well as any other concerns they may have with the proposal. In particular, the Commission invites the written views of interested persons concerning whether the proposal is consistent with Section 6(b)(5)<sup>25</sup> or any other provision of the Act, or the rules and regulations thereunder. Although there do not appear to be any issues relevant to approval or disapproval that would be facilitated by an oral presentation of views, data, and arguments, the Commission will consider, pursuant to Rule 19b-4 under the Act,<sup>26</sup> any request for an opportunity to make an oral presentation.<sup>27</sup>

Interested persons are invited to submit written data, views, and arguments regarding whether the proposal should be approved or disapproved by May 15, 2020. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal by May 29, 2020. 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 email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Numbers SR-NYSEArca-2020-01 on the subject line.

#### Paper Comments

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

All submissions should refer to File Number SR-NYSEArca-2020-01. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street NE, Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. 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-NYSEArca-2020-01 and should be submitted on or before May 15, 2020. Rebuttal comments should be submitted by May 29, 2020.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>28</sup>

**J. Matthew DeLesDernier,**

*Assistant Secretary.*

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#### SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-88690; File No. SR-OCC-2020-003]

#### Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of Proposed Rule Change Related to Proposed Changes to The Options Clearing Corporation's Framework for Liquidity Risk Management

April 20, 2020.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act" or "Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on April 6, 2020, 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 primarily by OCC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The proposed rule change would amend OCC's Rules, adopt a new Liquidity Risk Management Framework ("LRMF"), and revise OCC's Clearing Fund and stress testing methodology ("Methodology Description") to enhance OCC's management of liquidity risk and the sizing and monitoring of OCC's liquidity resources. Specifically, the proposed changes would:

(1) Establish a new LRMF document to provide a comprehensive overview of OCC's liquidity risk management practices and govern OCC's policies and procedures as they relate to liquidity risk management;

(2) enhance OCC's Methodology Description to describe OCC's approach to stress testing and determining the adequacy, sizing, and sufficiency of its liquidity resources;

(3) modify OCC's authority to set and increase the Clearing Fund Cash Requirement;

(4) implement a new two-day notice period for substitutions for Clearing Fund cash in excess of a Clearing Member's minimum requirement;

(5) enhance OCC's Rules and Contingency Funding Plan for collecting additional liquidity resources when a Clearing Member Group's projected or

<sup>23</sup> 15 U.S.C. 78f(b)(5).

<sup>24</sup> 15 U.S.C. 78f(b)(5).

<sup>25</sup> 15 U.S.C. 78f(b)(5).

<sup>26</sup> 17 CFR 240.19b-4.

<sup>27</sup> Section 19(b)(2) of the Exchange Act, as amended by the Securities Act Amendments of 1975, Public Law 94-29 (June 4, 1975), grants the Commission flexibility to determine what type of proceeding—either oral or notice and opportunity for written comments—is appropriate for consideration of a particular proposal by a self-regulatory organization. See Securities Act Amendments of 1975, Senate Comm. on Banking, Housing & Urban Affairs, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

<sup>28</sup> 17 CFR 200.30-3(a)(12).

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

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

actual liquidity risk exceeds certain defined thresholds;

(6) amend Chapter VI of the Rules to allow OCC to require cash margin as a protective measure if a Clearing Member is determined to present increased credit risk and is subject to enhanced monitoring and surveillance under the Corporation's watch level reporting process;

(7) amend Chapter X of the Rules to clarify OCC's authority to borrow Clearing Fund assets for liquidity risk management purposes;

(8) amend Chapter III of the Rules regarding the financial requirements applicable to Clearing Members to require that Clearing Members maintain adequate procedures and controls to ensure that it can meet its obligations when owed in connection with membership; and

(9) make a number of other clarifying, conforming, and organizational changes to OCC's Rules, Risk Management Framework Policy ("RMF Policy"), Clearing Fund Methodology Policy ("CFM Policy"), Collateral Risk Management Policy, Counterparty Credit Risk Management Policy ("CCRM Policy"), and Default Management Policy as described herein.

The proposed amendments to OCC's Rules can be found in Exhibit 5A. The proposed LRMF and Methodology Description have been submitted in confidential Exhibits 5B and 5C, respectively. Proposed changes to the RMF Policy, CFM Policy, Collateral Risk Management Policy, CCRM Policy, and Default Management Policy (collectively, "Risk Policies") have been submitted in confidential Exhibits 5D–5H. Material proposed to be added to the Rules, Methodology Description, and OCC Risk Policies as currently in effect is marked by underlining, and material proposed to be deleted is marked in strikethrough text. The LRMF has been submitted without marking to facilitate review and readability of the document as it is being submitted in its entirety as new rule text.

All terms with initial capitalization not defined herein have the same meaning as set forth in OCC's By-Laws and Rules.<sup>3</sup>

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

In its filing with the Commission, OCC included statements concerning the purpose of and basis for the proposed rule change and discussed any

comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. OCC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of these statements.

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

#### (1) Purpose

##### Background

As a central counterparty ("CCP"), OCC is exposed to liquidity risk, which is the risk that a counterparty, whether a participant or other entity, will have insufficient funds to meet its financial obligations as and when expected, although it may be able to do so in the future.<sup>4</sup> OCC's primary liquidity demands in a Clearing Member default originate from settlement obligations related to mark-to-market settlements on securities financing and futures transactions, expiring options, and liquidation of the Clearing Member's portfolio. Given the critical role OCC plays within the U.S. financial markets, it is vital that OCC maintains a robust framework for managing its liquidity risks. Such a framework should set forth the manner in which OCC effectively identifies, measures, monitors, and manages its liquidity risk. This includes, but is not limited to, how OCC: (1) Maintains sufficient liquid resources in all relevant currencies that enable OCC to meet its intraday, same-day, and multiday settlement obligations; (2) maintains a reliable and diverse set of committed liquidity resources with the flexibility and capacity to increase those resources should circumstances warrant; (3) conducts daily stress testing of potential liquidity demands under a wide range of historical and hypothetical scenarios; (4) maintains a contingent funding plan that allows OCC to collect additional liquidity resources when potential liquidity demands exceed liquidity resources; and (5) maintains a reliable and diverse set of liquidity providers and settlement banks that are risk managed through a comprehensive onboarding and monitoring process.

OCC maintains liquidity resources in the form of its "committed liquidity

facilities"<sup>5</sup> and a minimum cash contribution requirement for its Clearing Fund to ensure that it can meet its daily forecasted settlement obligations. From a committed liquidity facility perspective, OCC currently endeavors to maintain immediate liquid resources to meet observed peak settlements generated by any Clearing Member Group with a high degree of confidence. OCC also requires its Clearing Members to collectively contribute \$3 billion in cash to the Clearing Fund to provide an additional source of committed liquidity to OCC.

OCC sizes its liquidity resources based on historically observed liquidity demands and analysis of potential large forecasted liquidity demands. In certain cases, OCC's primary liquidity demands can be forecasted, and as a result, OCC currently establishes certain limits to ensure that it can detect aggregations of risk approaching its risk tolerances and mitigates these risks by requiring that the Clearing Member(s) driving the risk fulfill a specified portion of their margin requirement in cash (as discussed in further detail below). 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 it will maintain a positive liquidity position to meet settlement obligations.

#### Proposed Changes

OCC is proposing a number of enhancements to its rules intended to strengthen its overall resiliency, particularly with respect to OCC's management of liquidity risk and the sizing and monitoring of OCC's liquidity resources. Specifically, the proposed changes would:

(1) Establish a new LRMF document to provide a comprehensive overview of OCC's liquidity risk management practices and govern OCC's policies and procedures as they relate to liquidity risk management;

(2) enhance OCC's Methodology Description to describe OCC's approach to stress testing and determining the adequacy, sizing and sufficiency of its liquidity resources;

(3) modify OCC's authority to set and increase the Clearing Fund Cash Requirement;

(4) implement a new two-day notice period for substitutions for Clearing Fund cash in excess of a Clearing Member's minimum requirement;

<sup>3</sup> OCC's By-Laws and Rules can be found on OCC's public website: <http://optionsclearing.com/about/publications/bylaws.jsp>.

<sup>4</sup> See Committee on Payment and Settlement Systems and Technical Committee of the International Organization of Securities Commissions, *Principles for financial market infrastructures* (April 16, 2012), available at <http://www.bis.org/publ/cpss101a.pdf>.

<sup>5</sup> OCC's committed liquidity facilities may be comprised of both bank and non-bank committed facilities.

(5) enhance OCC's Rules and Contingency Funding Plan for collecting additional liquidity resources when a Clearing Member Group's projected or actual liquidity risk exceeds certain defined thresholds;

(6) amend Chapter VI of the Rules to allow OCC to require cash margin as a protective measure if a Clearing Member is determined to present increased credit risk and is subject to enhanced monitoring and surveillance under the Corporation's watch level reporting process;

(7) amend Chapter X of the Rules to clarify OCC's authority to borrow Clearing Fund assets for liquidity risk management purposes;

(8) amend Chapter III of the Rules regarding the financial requirements applicable to Clearing Members to require that Clearing Members maintain adequate procedures and controls to ensure that it can meet its obligations when owed in connection with membership; and

(9) make a number of other clarifying, conforming, and organizational changes to the OCC Rules and Risk Policies as described herein.

#### 1. Liquidity Risk Management Framework

OCC proposes to adopt a new LRMF to set forth the manner in which OCC effectively measures, monitors, and manages its liquidity risks, including how OCC measures, monitors, and manages its settlement and funding flows on an ongoing and timely basis, and its use of intraday liquidity. Specifically, the LRMF would describe: (1) The identification of OCC's liquidity risks; (2) the categories and types of OCC's liquidity resources; (3) the stress testing and sizing of OCC's liquidity resources; (4) OCC's Contingency Funding Plan for collecting additional liquidity resources from Clearing Members; (5) the risk management of supporting institutions (*e.g.*, settlement banks, custodian banks, and liquidity providers) that may present liquidity risks to OCC; and (6) the governance and reporting requirements concerning OCC's liquidity risk management. The proposed LRMF would govern OCC's policies and procedures as they relate to liquidity risk management and is described in further detail below.

#### Identification of Liquidity Risk

The LRMF would describe the primary liquidity risks OCC faces, which occur between the point of a Clearing Member default and the completion of the liquidation and settlement of the defaulted Clearing Member's obligations. OCC collects its

credit resources with an assumption of a two-day margin period of risk, and potential liquidity obligations are evaluated using that same concept and assuming the liquidation processes detailed in OCC's Default Management Policy.<sup>6</sup> If the liquidity demands result from a Clearing Member as part of an external cross-margin relationship, then potential liquidity obligations are evaluated in accordance with the provisions of the applicable cross-margin agreement. The potential liquidity obligations arising from a Clearing Member default that may require OCC to make same-day settlement obligations during the period between default and the conclusion of a liquidation of a defaulting Clearing Member's portfolio are included when estimating the size of OCC's liquidity demands for purposes of sizing its liquidity resources. These obligations may include mark-to-market obligations on futures and stock loan positions, trade premiums, cash-settled exercise and assignment ("E&A") activity, auction payments, settlements resulting from the E&A of physically-settled options, and funding of OCC's liquidation agents.

The LRMF would describe other factors and considerations identified by OCC that are not part of its liquidity resource determinations, such as margin deficits and other payments associated with a liquidation (*e.g.*, brokerage, bank, and legal fees). These factors are not included in OCC's liquidity resource determinations because, by their nature, they do not generally create immediate liquidity demands that could impede settlement. OCC also does not consider hedging costs in its liquidity resource determinations because OCC's primary goal is to liquidate positions prior to the need for hedging, and hedging would only be employed if OCC's liquidation activities were unexpectedly delayed. In addition, the LRMF would identify other liquidity risks that are not included in its liquidity resource sizing evaluation but have a potential impact on the management of liquidity risk, such as liquidity provider failures, custodian or settlement bank failures or operational disruptions, and concentration risks from settlement banks and liquidity providers. These risks are mitigated through various tools and processes discussed further below.

<sup>6</sup> See Securities Exchange Act Release No. 82310 (December 13, 2017), 82 FR 60265 (December 19, 2017) (SR-OCC-2017-010) (Order Approving Proposed Rule Change Relating to The Options Clearing Corporation's Default Management Policy).

#### Liquidity Resources

The proposed LRMF would describe the various categories and types of liquidity resources maintained by OCC, including the qualifying liquid resources (as defined in Exchange Act Rule 17Ad-22(a)(14))<sup>7</sup> maintained by OCC to meet its minimum liquidity resource requirement for effecting same-day, intraday and multiday settlement of OCC's payment obligations. Under the proposed LRMF, OCC would maintain the following categories of liquidity resources: (1) "Base Liquidity Resources," (2) "Available Liquidity Resources," (3) "Required Liquidity Resources," and (4) "Other Liquidity Resources." The proposed LRMF would set forth OCC's requirements for Base Liquidity Resources, which are comprised of qualifying liquid resources in the form of assets that are readily available and convertible into cash through prearranged funding arrangements<sup>8</sup> and required Clearing Fund cash on deposit.<sup>9</sup> Base Liquidity Resources would be set at an amount determined by OCC's Board of Directors ("Board") based on comprehensive analysis including stress testing so that OCC maintains sufficient liquid resources at the minimum in all relevant currencies to effect same-day and, where appropriate, intraday and multiday settlement of payment obligations with a high degree of confidence under a wide range of foreseeable 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

<sup>7</sup> 17 CFR 240.17Ad-22(a)(14).

<sup>8</sup> As noted above, OCC endeavors to maintain committed liquidity facilities with both bank and non-bank counterparties. OCC currently maintains a committed credit facility syndicated among various commercial banks. OCC also attempts to maintain committed repurchase agreements, which may be with both bank and non-bank counterparties. Under the proposed LRMF, OCC would endeavor to enter into agreements with liquidity providers (*i.e.*, committed lines of credit and committed repurchase agreements) that do not contain material adverse change ("MAC") provisions. In the event OCC is unable to obtain an agreement without a MAC provision, OCC would attempt to enter into other prearranged funding agreements. In order to qualify as Base Liquidity Resources, these other arrangements must be highly reliable in extreme but plausible market conditions, as determined by OCC's Board, following a review conducted prior to execution, and on an ongoing basis, but not less than annually.

<sup>9</sup> OCC Rule 1002(a)(i) currently requires Clearing Members to collectively contribute \$3 billion in U.S. dollar cash, the currency of all OCC liquidity obligations, to the Clearing Fund, which is held at either the Federal Reserve Bank of Chicago or a commercial bank approved as an OCC cash custodian. Cash held at a commercial bank may be invested in overnight reverse repurchase agreements.

but plausible market conditions. The LRMF would also describe how OCC ensures that it is continuously able to access the full amount of its committed liquidity facilities. Further, the LRMF would require that any borrowing from Base Liquidity Resources must be approved by OCC's Executive Chairman, Chief Executive Officer, or Chief Operating Officer (collectively referred to as the "Office of the Chief Executive Officer," "Office of the CEO," or "OCEO").

The LRMF would further describe how OCC uses the Clearing Fund as a source of liquidity (either directly or by using Clearing Fund assets to borrow or obtain funds from third parties) in the event a Clearing Member defaults on an obligation to OCC, in the event any bank or securities or commodities clearing organization defaults on its obligations to OCC, or to facilitate OCC's completion of same-day settlement obligations in the event of an operational disruption at a bank or securities or commodities clearing organization, consistent with OCC's Rules.<sup>10</sup>

The proposed LRMF also defines OCC's Available Liquidity Resources, which are comprised of OCC's Base Liquidity Resources plus Clearing Fund cash deposits in excess of the minimum required amount.<sup>11</sup> These resources are intended to supplement OCC's Base Liquidity Resources and are included in the calculation to determine liquidity resources available to OCC on a given day. As described further below, OCC would generally require a two-day notification period if a Clearing Member requests to substitute Government Securities for cash deposits above their minimum requirement. Once the substitution request is made, OCC would remove the cash deposits in question from subsequent Contingency Funding Plan calculations.

The proposed LRMF would describe OCC's Required Liquidity Resources, which are comprised of OCC's Available Liquidity Resources plus any amount of cash margin deposits of a Clearing Member Group required under the Contingency Funding Plan (described in further detail below). These required cash margin deposits supplement OCC's

Base Liquidity Resources and are only included as a Required Liquidity Resource for the Clearing Member Group from which they are called.

In addition, the LRMF would describe Other Liquidity Resources, which are those liquid resources that may or may not be available to OCC in a default situation (e.g., non-compulsory cash deposits of the defaulting Clearing Member; other margin deposits of the defaulting Clearing Member, including letters of credit, Government Securities, and Government Sponsored Entity securities that may be liquidated for same-day or next day settlement). Other Liquidity Resources are not committed resources; therefore, they are not included in OCC's Base, Available, or Required Liquidity Resource calculations. These resources may, however, be available in a default situation and could be used to address foreseeable liquidity shortfalls that would not be covered by OCC's committed resources and help OCC seek to avoid unwinding, revoking, or delaying the same-day settlement of payment obligations.

In addition, the LRMF would describe generally how OCC would utilize its liquidity resources in accordance with its Default Management Policy and the actions OCC would take if it needs to increase its liquidity resources to respond to changing business or market conditions (such as increasing the Clearing Fund Cash Requirement pursuant to Rule 1002(a) or using any uncommitted accordion<sup>12</sup> features embedded in any syndicated credit facility).

#### Stress Testing and Liquidity Resource Sizing

The proposed LRMF would describe OCC's overall approach to liquidity stress testing and liquidity resource sizing. Under the proposed LRMF, OCC would perform daily stress testing using standard and predetermined parameters and assumptions. The proposed approach to liquidity stress testing would rely on the stressed scenarios and prices generated under OCC's current stress testing and Clearing Fund methodology.<sup>13</sup> The scenarios used are pre-identified by OCC's Stress Test Working Group ("STWG") and the output of these scenarios would be used for liquidity resource evaluation and would be reviewed daily by OCC's Financial Risk Management department

("FRM").<sup>14</sup> The stress tests in question consider a range of relevant stress scenarios and possible price changes in liquidation periods, including but not limited to: (1) Relevant peak historic price volatilities; (2) shifts in other market factors including, as appropriate, price determinants and yield curves; (3) the default of one or multiple members; (4) forward-looking stress scenarios; and (5) reverse stress tests aimed at identifying extreme default scenarios and extreme market conditions for which the OCC's resources would be insufficient.

Under the proposed LRMF, the minimum amount of OCC's Base Liquidity Resources would be determined by OCC's Board based on a recommendation from OCC's Risk Committee. On an annual basis (or more frequently as needed),<sup>15</sup> FRM would present to the Board and Risk Committee an analysis summarizing the projected liquidity demands OCC may face under a variety of stress scenarios, including the sufficiency of OCC's Base Liquidity Resources against OCC's liquidity risk tolerance, extreme historical scenarios such as a 1987 historical market event and 2008 historical market event, and certain scenarios used to size OCC's Clearing Fund.<sup>16</sup> This analysis may also include the results of a comprehensive review of

<sup>14</sup> Under the proposed LRMF and Methodology Description, the output of these stress test scenarios would assume that the National Securities Clearing Corporation ("NSCC") accepts and guarantees all E&A activity under the Stock Options and Futures Settlement Agreement by and between OCC and NSCC. See OCC Rule 901 and Securities Exchange Act Release No. 81266 (July 31, 2017), 82 FR 36484 (August 4, 2017) (SR-OCC-2017-013) (Order Approving Proposed Rule Changes Concerning the Adoption of a New Stock Options and Futures Settlement Agreement Between the National Securities Clearing Corporation and The Options Clearing Corporation) and Securities Exchange Act Release No. 81260 (July 31, 2017), 82 FR 36476 (August 4, 2017) (SR-OCC-2017-804) (Notice of No Objection to Advance Notices Concerning the Adoption of a New Stock Options and Futures Settlement Agreement Between the National Securities Clearing Corporation and The Options Clearing Corporation). OCC plans to submit separate regulatory filings to address liquidity risk that may be posed by limited scenarios where NSCC may not accept and guaranty all E&A transactions associated with a defaulted Clearing Member.

<sup>15</sup> See the "Governance and Reporting" section below, which discusses the proposed process for reporting and escalating material issues identified with respect to the adequacy of OCC's liquidity resources.

<sup>16</sup> Given the different coverage standards used by OCC to calculate its credit and liquidity resources (i.e., Cover 2 versus Cover 1, respectively) and the potential limitations on the frequency with which OCC would be able to adjust the size of certain of its liquidity resources (e.g., its committed credit facilities and repurchase agreements), the Board and Risk Committee could consider the analysis provided in part, or its entirety, for the purposes of determining the size of Base Liquidity Resources.

<sup>10</sup> See Securities Exchange Release No. 82296 (December 12, 2017), 82 FR 59685 (December 15, 2017) (SR-OCC-2017-806). See also Securities Exchange Release No. 82501 (January 12, 2018), 83 FR 2843 (January 19, 2018) (SR-OCC-2017-808).

<sup>11</sup> These excess amounts are only included in Available Liquidity Resources by the amount the required Clearing Fund size exceeds the minimum Clearing Fund sized as determined by OCC Rule 1001(b). Cash deposits in excess of a Clearing Member's total Clearing Fund requirement would not be included.

<sup>12</sup> An accordion is an uncommitted expansion of the credit facility generally on the same terms as the credit facility.

<sup>13</sup> See *infra* notes 21 and 22 and associated text.

any parameters and assumptions used by OCC's stress testing system, the output of which is used to project potential liquidity demands under stressed market conditions.<sup>17</sup> In addition, the analysis may include the current composition of OCC's various liquidity resources and recommended changes, if applicable.

OCC's approach to liquidity stress testing and the proposed changes to OCC's Methodology Description are discussed in further detail below.

#### Contingency Funding Plan

The proposed LRMF would describe OCC's Contingency Funding Plan, which enables OCC to: (1) Collect additional liquidity resources from a Clearing Member Group when that Clearing Member Group's projected or actual liquidity risk exceeds certain thresholds or (2) quickly supplement OCC's Available Liquidity Resources outside of the annual sizing process, should the circumstances warrant. The Contingency Funding Plan and associated OCC Rule changes are discussed in more detail in the "Contingency Funding Plan" section below.

#### Supporting Institutions

OCC's management of liquidity risk is dependent on a number of supporting institutions, such as settlement banks, custodian banks, central banks, and liquidity providers. The LRMF would describe OCC's overall framework for monitoring, managing, and limiting its risks and exposures to these supporting institutions, which is primarily governed by OCC's CCRM Policy.<sup>18</sup> This includes rigorous onboarding and monitoring processes, including but not limited to: (1) Conducting initial and ongoing due diligence to confirm each commercial institution meets OCC's financial and operational standards; (2) confirming that each commercial institution has access to liquidity to meet its commitments to OCC; (3) monitoring and managing direct, affiliated, and concentrated exposures; and (4) meeting with these commercial institutions and conducting operational reviews as required by OCC's policies and procedures. The proposed LRMF would also set forth OCC's requirements for performing due diligence to confirm

it has a reasonable basis to believe each of its liquidity providers has (1) sufficient information to understand and manage the potential liquidity demands of OCC and its associated liquidity risk and (2) the capacity to perform as required under its commitments, including the execution of periodic test borrows no less than once every 12 months to measure the performance and reliability of the liquidity facilities. The proposed LRMF would also describe OCC's use of accounts and services at the Federal Reserve Bank of Chicago, and in particular, its use of accounts at the Federal Reserve Bank of Chicago to custody funds to reduce counterparty credit risks.

#### Governance and Reporting

The proposed LRMF would set forth the governance, review, monitoring, and reporting activities performed by OCC with respect to liquidity risk management. On a daily basis, FRM would be responsible for reviewing the results of OCC's liquidity stress test exposures and the sufficiency of OCC's Base Liquidity Resources and Required Liquidity Resources, including the adequacy of such resources in covering OCC's risk tolerance. The chair of the STWG or the Executive Vice President of FRM would immediately escalate any material issues identified with respect to the adequacy of OCC's liquidity resources to the Credit and Liquidity Risk Working Group ("CLRWG")<sup>19</sup> to determine if it would be appropriate to recommend a change the size of OCC's Base Liquidity Resources in accordance with relevant procedure(s).

On at least a monthly basis, FRM would prepare reports that provide details and trend analysis of daily stress tests with respect to the Base Liquidity Resources, including the results of daily stress tests and a review of the adequacy of OCC's liquidity resources, and provide these reports to the STWG. The STWG would perform a comprehensive review of the existing stress test results and scenarios, and their underlying parameters and assumptions, the output of which is used to project liquidity demands, and consequently evaluate their appropriateness for determining the level of liquidity resources that OCC must maintain under current and evolving market conditions and consider proposed enhancements to the scenarios used for stress testing based on the results of this comprehensive review. Such an analysis would be

conducted more frequently than monthly when products cleared or markets served display high volatility or become less liquid, or when the size or concentration of positions held by OCC's participants increases significantly.<sup>20</sup> In addition, FRM would be responsible for preparing a summary of the adequacy of OCC's Base and Available Liquidity Resources, as well as actions taken under the Contingency Funding Plan, and results from its monthly comprehensive review to provide to OCC's Management Committee and Risk Committee to demonstrate compliance with OCC's minimum liquidity resource requirements. If needed, any issues that are detected with respect to the adequacy of OCC's Base Liquidity Resources would be promptly escalated to the Management Committee intra-month pursuant to FRM procedures. In the performance of monthly review of liquidity results and analysis, and when considering whether escalation is appropriate, due consideration would be given to the intended purpose of the proposed LRMF to: (1) Assess the adequacy of, and adjust as necessary, OCC's Base Liquidity Resources; (2) support compliance with the minimum requirements under applicable regulations; and (3) and any other relevant aspects of OCC's liquidity risk management.

On at least an annual basis, FRM would assess the adequacy of OCC's stress testing methodology, the output of which is used to evaluate OCC's liquidity resource risks. Proposed changes resulting from such review would be sent to the Risk Committee for approval. In addition, the CLRWG would be responsible for reviewing the LRMF and any and liquidity resource sizing recommendations, with proposed changes resulting from such review being sent to the Risk Committee for approval. Finally, on at least an annual basis, OCC's Model Validation Group would perform a review of risk methodologies and the usage of any models to inform the management of liquidity risk.

#### 2. Liquidity Stress Testing

OCC proposes to enhance its management of liquidity risk by introducing a new approach to stress testing and determining the adequacy, sizing, and sufficiency of its liquidity resources. OCC's liquidity stress testing would be based on output of its current

<sup>17</sup> These parameters and assumptions are routinely reviewed by STWG, on at least a monthly basis.

<sup>18</sup> See Securities Exchange Act Release No. 82312 (December 13, 2017), 82 FR 60242 (December 19, 2017) (SR-OCC-2017-009) (Order Approving Proposed Rule Change Relating to The Options Clearing Corporation's Counterparty Credit Risk Management Policy).

<sup>19</sup> If escalation to the CLRWG is not practical, issues would be escalated to OCC's Management Committee.

<sup>20</sup> FRM would maintain procedures for determining whether, and in what circumstances, such intra-month reviews shall be conducted, and which officers have responsibility for making the determination.

stress testing and Clearing Fund methodology,<sup>21</sup> which would be used to project OCC's potential liquidity demands under stressed market conditions.

#### Current Stress Testing Approach for Clearing Fund

OCC determines its Clearing Fund size based on the results of stress tests conducted daily using standard predetermined parameters and assumptions. These daily stress tests consider a range of relevant stress scenarios and possible price changes in liquidation periods, including but not limited to: (1) Relevant peak historic price volatilities; (2) shifts in other market factors including, as appropriate, price determinants and yield curves; and (3) the default of one or multiple Clearing Members. OCC also conducts reverse stress tests for informational purposes aimed at identifying extreme default scenarios and extreme market conditions for which the OCC's financial resources may be insufficient.

As set forth in the Methodology Description, the methodology includes two primary types of scenarios: "Historical Scenarios" and "Hypothetical Scenarios." Historical Scenarios attempt to replicate historical events in current market conditions, which includes the set of currently existing securities, their prices, and volatility levels. These scenarios provide OCC with information regarding pre-defined reference points determined to be relevant benchmarks for assessing OCC's exposure to Clearing Members and the sufficiency of its financial resources. Hypothetical Scenarios represent events in which market conditions change in ways that have not yet been observed. The Hypothetical Scenarios are derived using statistical methods (e.g., draws from estimated multivariate distributions) or created based on a mix of statistical techniques and expert judgment (e.g., a 15% decline in market prices and 50% increase in volatility). These scenarios give OCC the ability to change the distribution and level of stress in ways necessary to produce an effective forward-looking stress testing

methodology. OCC uses these pre-determined stress scenarios in stress tests, conducted on a daily basis, to determine OCC's risk exposure to each Clearing Member Group by simulating the profits and losses of the positions in their respective account portfolios under each such stress scenario.

OCC performs daily stress testing using a wide range of scenarios, both Hypothetical and Historical, designed to serve multiple purposes. OCC's stress testing inventory contains scenarios designed to: (1) Determine whether the financial resources collected from all Clearing Members collectively are adequate to cover OCC's risk tolerance ("CF Adequacy Scenarios"); (2) establish the monthly size of the Clearing Fund necessary for OCC to maintain sufficient pre-funded financial resources to cover losses arising from the default of the two Clearing Member Groups that would potentially cause the largest aggregate credit exposure to OCC as a result of a 1-in-80 year hypothetical market event ("CF Sizing Scenarios"); (3) measure the exposure of the Clearing Fund to the portfolios of individual Clearing Member Groups, and determine whether any such exposure is sufficiently large as to necessitate OCC calling for additional resources so that OCC continues to maintain sufficient financial resources to guard against potential losses under a wide range of stress scenarios, including extreme but plausible market conditions ("CF Sufficiency Scenarios");<sup>22</sup> and (4) monitor and assess the size of OCC's pre-funded financial resource against a wide range of stress scenarios that may include extreme but implausible and reverse stress testing scenarios ("CF Informational Scenarios").

#### Proposed Liquidity Stress Testing

OCC proposes to revise its Methodology Description to enable OCC to use the output of its current stress testing methodology to determine the adequacy, sizing, and sufficiency of OCC's liquidity resources. The proposed revisions to the Methodology Description would primarily address the construction and aggregation of stress

test portfolios and add a new section to discuss how OCC would calculate its stressed liquidity demands.

#### Portfolio Construction and Aggregation

The revised Methodology Description would describe how OCC endeavors to construct Clearing Member portfolios and aggregate results consistent with business practices that would be followed in an actual liquidation of a defaulter's portfolio. Currently, the Methodology Description describes OCC's process for creating the "Synthetic Accounts" used in credit stress testing. When aggregating results for credit purposes, the focus is on calculating the liquidating value of the portfolio. OCC would revise the Methodology Description to describe OCC's process for portfolio construction and aggregation for liquidity stress testing purposes under the proposed LRMF. Specifically, the Methodology Description would be revised to highlight the importance of the timing of the cashflows from the liquidation since an offsetting debit and credit may occur on different days thus creating a liquidity demand when there is no credit demand. The Methodology Description would also be revised to clarify that Clearing Member positions are held in accounts based on a business type classification and/or by cross margining relationships with other clearing houses, and in many instances, Clearing Members maintain several accounts of the same business type.

OCC also proposes to revise the Methodology Description to streamline the description of how OCC aggregates positions into stress test accounts and closes certain positions out to account for differences in aggregation for credit and liquidity purposes. For example, Rule 1106(d) provides that, in lieu of closing long positions and short positions in the same series of cleared contract carried by a suspended Clearing Member through closing transactions on an Exchange, OCC is permitted to close long and short positions of a suspended Clearing Member in the same series by offset. OCC refers to this process of closing long and short positions in the same series in the same account type as "netting"<sup>23</sup> and closing long and short positions in the same series between

<sup>21</sup> See Securities Exchange Act Release No. 83714 (July 26, 2018), 83 FR 37570 (August 1, 2018) (SR-OCC-2018-803) (Notice of No Objection to Advance Notice, as Modified by Amendments No. 1 and 2, Concerning Proposed Changes to The Options Clearing Corporation's Stress Testing and Clearing Fund Methodology) and Securities Exchange Act Release No. 83735 (July 27, 2018), 83 FR 37855 (August 2, 2018) (SR-OCC-2018-008) (Order Approving Proposed Rule Change, as Modified by Amendments No. 1 and 2, Related to The Options Clearing Corporation's Stress Testing and Clearing Fund Methodology).

<sup>22</sup> Under OCC Rule 609, the Policy, and the Methodology Description, if a CF Sufficiency Stress Test identifies exposures that exceed 75% of the current Clearing Fund requirement less deficits (the "75% threshold" or "Sufficiency Stress Test Threshold 1"), OCC may require additional margin deposits from the Clearing Member Group(s) driving the breach. All such margin calls must be approved by a Vice President (or higher) of FRM; however, if the margin call imposed on an individual Clearing Member exceeds \$500 million, OCC's Stress Testing and Liquidity Risk Management group ("STLRM") must provide written notification to the Office of the CEO.

<sup>23</sup> For example, a customer account may be long 10 contracts and short 5 contracts in the same series. After netting, the customer account will be long 5 contracts in the series, but there is no need to transfer a marking price associated with the effective sale of the 5 long contracts because the closure by offset is accomplished within the same account type.

account types as “internalization.”<sup>24</sup> For internalization, proceeds associated with the close out would be debited and credited, as applicable, between the account types involved and the proceeds would be tracked and included in subsequent calculations of the liquidating value associated with each account type.<sup>25</sup> The aggregation of results from an account to a Clearing Member or Clearing Member Group level is designed to follow how OCC would account for the proceeds during an actual Clearing Member liquidation. For instance, positions and collateral credited to a particular type of Clearing Member account (*e.g.*, customer, firm or market-maker) are, depending on the account type, potentially subject to a lien<sup>26</sup> in favor of OCC. Specifically, OCC’s By-Laws and Rules contemplate that the positions and collateral in an account may be subject to a “general lien”<sup>27</sup> or a “restricted lien”<sup>28</sup> in favor of OCC. It is also the case that in some instances there is no lien in favor of OCC (*e.g.*, segregated long options positions in the customers’ account).<sup>29</sup> These liens (or the absence of any lien) are respected when summing results from a business account type level to

the Clearing Member level, and then all Clearing Member results are summed to a Clearing Member Group level; however, OCC may not use a credit of one legal entity to offset losses of another affiliated legal entity.

#### Liquidity Stress Testing

OCC proposes to revise the Methodology Description to describe how OCC would use the output from its current stress testing system to measure and monitor the sufficiency of OCC’s liquidity resources. The Methodology Description would be revised to generally summarize OCC’s LRMF and to set forth key assumptions in the construction of its liquidity calculations. For example, for purposes of its liquidity calculations, OCC would assume: (1) A liquidation horizon of two days (which aligns with its two-day margin period of risk); (2) that a Clearing Member default occurs sometime after the collection of collateral on the day before the default (D–1) up to or at settlement on day of default (D); (3) that cash-settled option liquidity demands due on the morning of default are conservatively calculated using gross positions; (4) NSCC normally guarantees the settlement of any E&A transactions;<sup>30</sup> (5) OCC accounts for liquidity demands as required by relevant cross-margin agreements; (6) that auction bids are represented by stressed prices at the contract level; (7) that credits that occur on the first day of a liquidation persist and are available to offset debits on subsequent days; (8) that auction proceeds settle on D+2; (9) liquidity demands associated with Specific Wrong Way Risk (“SWWR”) positions are included in the appropriate calculations; and (10) early exercise is not assumed in estimating liquidity demands.<sup>31</sup>

<sup>30</sup> OCC also projects liquidity demands for using a liquidation agent to act as a “substitute broker” for informational purposes. “Substitute broker” refers to the use of another OCC clearing member that remains in good standing at NSCC and that, on OCC’s behalf, will facilitate settlement of OCC’s delivery obligations of the E&A transactions at NSCC.

<sup>31</sup> OCC recognizes that early exercises may potentially be incentivized by certain situations, such as a favorable present value of interest income that can be earned on strike premium over the remaining life of a contract for deep in-the-money puts or with dividend capture strategies on call contracts, where the dividend amount exceeds the costs associated with purchasing the underlying stock and a related put contract having an identical strike and expiration. However, OCC believes standard expiration is generally more meaningful than early exercise risk when calculating the liquidity risk associated with E&A activity. For example, OCC reviewed early exercises during a period of market stress, specifically, the days leading up to, and immediately following, the

Under the proposed approach, OCC would assume that positions<sup>32</sup> with an expiration date of D+1 or greater will be liquidated via auction. With respect to collateral positions, accounts with excess collateral would be evaluated and adjusted since excess collateral may be withdrawn prior to default. If there is excess collateral, the portfolio would be adjusted by removing excess cash, letters of credit, government securities, and valued securities in that order until no excess collateral remains. In addition, any option positions expiring on D–1 or D would be evaluated for moneyness,<sup>33</sup> and then assumed to be liquidated through normal OCC cash settlement processes or through physical settlement at NSCC. Moreover, under the proposed approach, credits from earlier dates would only reduce debits for later dates when evaluating liquidity demands.

As discussed above, the proposed approach to liquidity stress testing would assume that NSCC accepts and guarantees all E&A activity under the Stock Options and Futures Settlement Agreement by and between OCC and NSCC.<sup>34</sup> In the unlikely event there is a rejection by NSCC, OCC would attempt to use a liquidation agent acting as a substitute broker to settle the E&A activity through NSCC. This method of settlement would not be used in OCC’s liquidity resource sizing assumptions, but OCC would monitor the potential liquidity demands through the use of informational stress test scenarios, which would be part of OCC’s daily stress testing and monitored and reported regularly to the STWG.

OCC’s proposed approach to liquidity stress testing would utilize output from its current stress testing methodology, and the same scenarios would be used for Sufficiency and Adequacy stress testing. OCC would perform daily liquidity risk stress testing using standard and predetermined parameters and assumptions, and the output of these scenarios would be used for

events of February 5, 2018. In comparison to all long equity put option open interest during this period, OCC found that less than one percent of equity put contracts were exercised early on February 5, 2018 and February 6, 2018, as opposed to the standard monthly February expiration, where a total of approximately six percent of equity calls and five percent of equity puts were exercised on February 16, 2018.

<sup>32</sup> Neither stock loan nor futures would be included in this calculation. Stock loan positions are handled through a separate buy-in/sell-out process. Futures positions are included in the auction portfolio, but mark-to-market calculations capture the liquidity risk that arises from futures.

<sup>33</sup> The term “moneyness” refers to the relationship between the current market price of the underlying interest and the exercise price.

<sup>34</sup> See *supra* note 14.

<sup>24</sup> For example, if the customer account is long 10 contracts in a particular series and the firm account is short 5 contracts in the same series, OCC would effectively create an “internalized transaction” to sell 5 contracts in the series from the customer account and purchase 5 contracts in the series from the firm account. OCC would debit the firm account for the marking price associated with the sale of the 5 contracts and credit the customer account in connection with the purchase. As a matter of the positions in the series maintained in each account, after the internalization, there would be 5 contracts remaining in the customer account and no positions in the firm account.

<sup>25</sup> *Id.*

<sup>26</sup> Pursuant to Article I, Section 1L(3) of OCC’s By-Laws, a “lien” is a “security interest” as defined in applicable provisions of the Uniform Commercial Code as in effect in the relevant jurisdictions and, where used in respect of OCC’s security interest in cleared contracts carried in the account of Clearing Members, shall include an “issuer’s lien” within the meaning of the 1977 amendments to the Uniform Commercial Code.

<sup>27</sup> “General lien” means that OCC has a security interest in all or specified assets in a Clearing Member account as security for all of the Clearing Member’s obligations to OCC regardless of the source or nature of such obligations. See Article I, Section 1G(1) of OCC’s By-Laws.

<sup>28</sup> A “restricted lien” is a security interest of OCC in specified assets (including any proceeds thereof) in an account of a Clearing Member with OCC as security for the Clearing Member’s obligations arising from such account or, to the extent so provided in the By-Laws or Rules, a specified group of accounts that includes such account including, without limitation, obligations in respect of all confirmed trades effected through such account or group of accounts, short positions maintained in such account or group of accounts, and exercise notices assigned to such account or group of accounts. See Article I, Section 1R(7) of OCC’s By-Laws.

<sup>29</sup> See Article VI, Section 3(e) of OCC’s By-Laws.



liquidity resource evaluation and reviewed daily by FRM. Specifically OCC's proposed liquidity stress tests would consist of a range of Historical and Hypothetical Scenarios, and the output would be used to: (1) Assess OCC's projected liquidity demands under stressed scenarios against OCC's Base and Available Liquidity Resources; (2) assess OCC's Base and Available Liquidity Resources against OCC's liquidity risk tolerance ("Adequacy Scenarios"); (3) measure the sufficiency of potential exposures in excess of OCC's liquidity resources to determine if additional risk mitigation is needed when those exposures indicate potential breaches of certain thresholds under OCC's Contingency Funding Plan ("Sufficiency Scenarios"); and (4) monitor and assess OCC's liquidity resources under a variety of stress conditions, which may include extreme but implausible scenarios and reverse stress test scenarios ("Informational Scenarios"). Under the proposed LRMF, Adequacy Scenarios would be used to evaluate OCC's Base Liquidity Resources against OCC's risk tolerance of a 1-in-50-year market event at a 99.5% confidence interval over a two-year look back period. The output of Sufficiency Scenarios would be used to assess potential liquidity exposures in excess of OCC's Available Liquidity Resources under a wide range of historical and hypothetical stress scenarios, including but not limited to, a 1987 historical market event and a 2008 historical market event, and if a Clearing Member Group's exposures breach certain thresholds, OCC would require the breaching Clearing Member Group to maintain cash deposits in lieu of other forms of acceptable collateral to supplement OCC's Available Liquidity Resources pursuant to the Contingency Funding Plan (discussed further below). The output of Informational Scenarios would be used to assess OCC's liquidity under a variety of extreme stress conditions, both plausible and implausible, as well as reverse stress tests.<sup>35</sup>

OCC also proposes to make other conforming and organizational changes to the Methodology Description to reflect the implementation of the new liquidity stress testing approach and make other non-substantive clarifications to the document. For

example, OCC would reorganize the document to relocate content specific to credit stress testing to sections of the document focused only on credit stress testing. OCC would also make clarifying and conforming changes to differentiate the usage of Adequacy, Sizing, Sufficiency, and Informational Scenarios for credit and liquidity purposes. OCC also proposes changes to more accurately describe the scope of volatility instruments cleared by OCC. In addition, OCC would clarify that in most SWWR stress test scenarios, SWWR Equity and ETN charges computed for margins are added to stress scenario profit and loss calculations in order to account for SWWR in the stress testing system.<sup>36</sup> OCC would also remove duplicative language regarding Idiosyncratic Scenarios, Sizing Scenarios, and certain key assumptions from the executive summary of the Methodology Description as this information is covered in greater detail later in later sections of the document.

### 3. Clearing Fund Cash Requirement Current Rules

Pursuant to OCC Rule 1002(a), Clearing Members are required to collectively contribute \$3 billion in cash to the Clearing Fund. In addition, OCC's Executive Chairman, Chief Executive Officer, and Chief Operating Officer each have the authority, 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 for the protection of OCC, Clearing Members or the general public. Any such determination must (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. Moreover, any temporary increase in the Cash Clearing Fund Requirement must be reviewed by the

Risk Committee as soon as practical (but in any event, such review must occur within 20 calendar days of such increase) and, if such temporary increase is still in effect, the Risk Committee shall determine whether (A) the increase in the Cash Clearing Fund Requirement is no longer required, or (B) OCC's rules should be modified to ensure that OCC continues to maintain sufficient liquidity resources.

In addition, Interpretation and Policy .03 to Rule 1002 Clearing Fund currently requires that any increase in the Cash Clearing Fund Requirement be satisfied no later than one hour before the close of the Fedwire on the business day following the issuance of an instruction to increase cash contributions.

### Proposed Changes

OCC proposes to amend Rule 1002(a) to modify its authority to set and to temporarily increase the minimum amount of cash required in its Clearing Fund.<sup>37</sup> The proposed rule change is intended to provide OCC with the flexibility to periodically set its Base Liquidity Resources and to adjust Base Liquidity Resources in response to changing market and business conditions to ensure that OCC maintains sufficient liquidity resources to cover its liquidity risk exposures at all times. OCC's Board would have the authority to periodically adjust the Clearing Fund Cash Requirement (typically during the annual review of OCC's Base Liquidity Resources as required under the proposed LRMF based on analysis of OCC's projected liquidity demands under a variety of stress scenarios.<sup>38</sup> However, revised Rule 1002(a) would require that the Clearing Fund Cash Requirement never be at set at an amount lower than \$3 billion.

In addition, OCC proposes to remove the description of the specific OCC officers authorized to temporarily increase the size of the Clearing Fund as this authority is already discussed in

<sup>37</sup> OCC also proposes non-substantive revisions to its Rules and OCC Risk Policies to redefine this requirement as the "Clearing Fund Cash Requirement."

<sup>38</sup> OCC's Risk Committee has initially determined that OCC's Clearing Fund Cash Requirement should be increased to \$3.5 billion based on an analysis of stress test results demonstrating that this amount, combined with OCC's committed liquidity facilities, should be sufficient to cover OCC's liquidity risk tolerance of a 1-in-50 year statistical market event at a 99.5% confidence level over a two-year look back period. In evaluating the proposed size of the Clearing Fund Cash Requirement, OCC analyzed stress test results for the period January 2017–June 2019. OCC would inform Clearing Members of any change in the Clearing Fund Cash Requirement through Information Memoranda and Clearing Fund sizing reports.

<sup>35</sup> Under the LRMF, the output of Informational Scenarios may inform decisions about the adequacy of OCC's liquidity resources but would not be directly used to make decisions regarding the size of OCC's liquidity resources. Informational Scenarios may, however, be re-categorized as Adequacy or Sufficiency upon the approval of the Risk Committee.

<sup>36</sup> See Securities Exchange Act Release No. 87673 (December 6, 2019), 84 FR 67981 (December 12, 2019) (SR–OCC–2019–807) (Notice of No Objection To Advance Notice Related to Proposed Changes to The Options Clearing Corporation's Rules, Margin Policy, Margin Methodology, Clearing Fund Methodology Policy, and Clearing Fund and Stress Testing Methodology To Address Specific Wrong-Way Risk) and Securities Exchange Act Release No. 87718 (December 11, 2019), 84 FR 68992 (December 17, 2019) (SR–OCC–2019–010) (Order Approving Proposed Rule Change Related to Proposed Changes to the Options Clearing Corporation's Rules, Margin Policy, Margin Methodology, Clearing Fund Methodology Policy, and Clearing Fund and Stress Testing Methodology To Address Specific Wrong-Way Risk).



OCC's CFM Policy and will also be described in the proposed LRMF.<sup>39</sup> Rule 1002(a)(i) would be revised to instead state that "the Corporation" shall have the authority to increase the amount of cash required to be maintained in the Clearing Fund. OCC believes the internal governance process for temporary increases in the Clearing Fund Cash Requirement are appropriately documented in its filed policies (and proposed LRMF) and that the proposed change would reduce the risk of potential inconsistencies between OCC's Rules and its filed policies.

OCC also proposes to modify Rule 1002(a)(i)(A) to provide that the Clearing Fund Cash Requirement may be temporarily increased "to respond to changing business or market conditions" for the protection of OCC, Clearing Members or the general public and to move certain existing criteria (*i.e.*, that any determination to implement a temporary increase in the Clearing Fund Cash Requirement (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) to be applied to the Risk Committee's review of any such increase. The proposed change would provide flexibility for OCC's executive management to increase liquidity resources as circumstances warrant and put into place more detailed criteria for the Risk Committee's review of such an increase when determining whether changes should be made on a more permanent basis.

Under the requirements of the proposed LRMF, the Risk Committee's review would include a determination as to whether the increase was appropriately made on a temporary basis or whether OCC's Liquidity Risk Management Framework, stress testing methodology, Base Liquidity Resources, or Contingency Funding Plan should be modified to ensure that OCC continues to maintain sufficient liquidity resources to meet its regulatory obligations. This determination would (1) be based upon then-existing facts and circumstances, (2) be in furtherance of the integrity of OCC and the stability of the financial system, and (3) take into consideration the legitimate interests of Clearing Members and market participants. In addition, the Risk

Committee would maintain sole authority to decrease the amount of the Clearing Fund Cash Requirement, incrementally or in full, to any amount greater than or equal to the amount set during the last yearly sizing process.<sup>40</sup> The LRMF would also clarify that any such increase may occur during the monthly Clearing Fund sizing process, or on an intra-month basis. The proposed rule change is designed to ensure that OCC maintains appropriate flexibility to manage its liquidity risks in response to changing market and business conditions while also providing an appropriate governance structure for making such decisions on a temporary basis (*i.e.*, through authority limited to OCC's executive management team) and for reviewing such decisions and making determinations on further enhancements to OCC's framework for managing liquidity risk (*i.e.*, through oversight and ultimate decision-making authority by OCC's Board-level Risk Committee).

OCC also proposes to amend Interpretation and Policy .03 to Rule 1002 to require that any increase in the Clearing Fund Cash Requirement be satisfied no later than the second business day following notification unless the Clearing Member is notified by an officer of OCC an alternative time to satisfy such obligation. Interpretation and Policy .03 to Rule 1002 currently requires Clearing Members to fund an increase in Clearing Fund Cash Requirement no later than one hour before the close of Fedwire on the business day following notification by OCC. The proposed change is intended to more closely align timeframes for meeting an increase in the Clearing Fund Cash Requirement with the timing for satisfying Clearing Fund deficits in the monthly and intra-month sizing processes. OCC believes that standardizing these timeframes would provide more clarity and simplicity in OCC's Rules and would help Clearing Members better understand and manage their obligations to OCC.

#### 4. Two-Day Notice Period for Substitutions Involving Excess Clearing Fund Cash

Under OCC's current operational practices, Clearing Members may substitute Government Securities for cash deposits in the Clearing Fund in excess of their minimum cash requirements, and such substitutions are generally completed on the same day of the request. OCC proposes to adopt new

Rule 1002(a)(iv) to introduce a two-day notice period for any Clearing Member requesting to substitute Government Securities for cash deposits in excess of such Clearing Member's proportionate share of the Clearing Fund Cash Requirement. For purposes of determining permitted substitution amounts and eligible cash withdrawals during any two-day notification period, deposits of Government Securities or any other non-cash collateral transactions that result in excess Clearing Fund contributions of the Clearing Member will not be deemed to be excess until the completion of the two-day notification period. The proposed rule change is intended to provide additional certainty around the level of liquidity resources available to OCC at any given time by fixing the amount of cash in the Clearing Fund, and thereby fixing the amount of OCC's Available Liquid Resources, for any given two-day liquidation horizon. Under the proposed LRMF, once the substitution request is made, OCC would remove the cash deposits in question from subsequent Contingency Funding Plan calculations (discussed below). OCC believes that the proposed change would also eventually result in a natural equilibrium of excess cash in Clearing Fund as Clearing Members determine how best to fund their Clearing Fund requirement. OCC notes that Clearing Members would continue to be able to immediately withdraw cash deposits that are above their Clearing Fund Cash Requirement provided that they have an equivalent amount of excess Clearing Fund deposits (as provided under Rule 1008).

Proposed Rule 1002(a)(iv) would also provide OCC with the discretion to waive the two-day notification period if the substitution would not result in any Clearing Member's settlement obligations, including potential settlement obligations under stressed market conditions, exceeding the liquidity resources available to satisfy such settlement obligations.

#### 5. Contingency Funding Plan

OCC proposes several enhancements to its Contingency Funding Plan, which would be described in the proposed Rules, LRMF, and Methodology Description. OCC's current Contingency Funding Plan and proposed changes thereto are discussed in detail below.

##### Current Process

OCC's Contingency Funding Plan primarily consists of a process by which OCC monitors and evaluates the reasonably anticipated settlement obligations of its Clearing Members

<sup>39</sup> OCC also proposes similar changes to Rule 1001(d) concerning temporary increases to the overall Clearing Fund Size. This authority is also discussed in OCC's CFM Policy.

<sup>40</sup> OCC notes that the Clearing Fund Cash Requirement would initially be set at \$3.5 billion.

against OCC's liquidity resources and calls for cash margin deposits in circumstances where such settlement obligations may exceed OCC's liquidity resources. In 2014, OCC filed a proposed rule change for immediate effectiveness that, among other things, required OCC to issue an intra-day margin call<sup>41</sup> in situations in which a Clearing Member's reasonably anticipated settlement obligations to OCC exceeded the liquid financial resources available to satisfy such obligations.<sup>42</sup> The filing made it clear that such action would be taken even if OCC has made no adverse determination as to the financial condition of the Clearing Member, the market risk of the Clearing Member's positions or the adequacy of the Clearing Member's total margin deposit in the accounts in question. One primary circumstance in which such action may be required is the "unwinding" of a "box spread" position.<sup>43</sup> Box spreads can be used as financing transactions, and they may require very large fixed payments upon expiration. In this situation, if the margin deposited by a Clearing Member participating in such a box spread is in the form of common stock, and if the Clearing Member failed to make the settlement payment, OCC's available liquid financial resources may be insufficient to cover the settlement obligation. In anticipation of such a settlement, OCC requires the Clearing Member to deposit intra-day margin in the form of cash so that OCC's liquid financial resources would be sufficient to cover the Clearing Member's obligations.<sup>44</sup>

<sup>41</sup> OCC Rule 609 provides OCC with the discretion to require the deposit of additional margin by any Clearing Member in any account at any time during a given business day.

<sup>42</sup> See Securities Exchange Act Release No. 72266 (May 28, 2014), 79 FR 32009 (June 3, 2014) (SR-OCC-2014-10) (Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Require That Intraday Margin be Collected and Margin Assets Not be Withdrawn When a Clearing Member's Reasonably Anticipated Settlement Obligations to OCC Would Exceed the Liquidity Resources Available to OCC to Satisfy Such Settlement Obligations).

<sup>43</sup> A box spread position involves a combination of two long and two short options on the same underlying interest with the same expiration date that results in an amount to be paid or received upon settlement that is fixed regardless of fluctuations in the price of the underlying interest. See <http://www.cboe.com/learncenter/glossary.aspx#b>.

<sup>44</sup> In advance of such margin call being made, a Clearing Member may elect to deposit margin in the form of cash, thereby increasing liquid resources available to OCC. If a margin deposit in the form of cash is made by the Clearing Member before the call is issued, it may obviate the need for the call altogether.

Currently, OCC generally monitors for potential liquidity shortfalls beginning thirty days prior to a given settlement. For purposes of determining whether the reasonably anticipated settlement obligations of a Clearing Member Group may exceed the liquid financial resources available to satisfy such obligations, OCC compares the forecasted liquidity amount against the drawable amount of its committed liquidity facilities.<sup>45</sup>

#### Proposed Changes

OCC proposes to make several enhancements to its Contingency Funding Plan, which are discussed in detail below.

#### Stress Test-Based Forecasting

As discussed above, OCC's proposed approach to liquidity stress testing would include the use of certain Sufficiency Scenarios designed to assess potential liquidity exposures in excess of OCC's Available Liquidity Resources. OCC proposes to use the output of these Sufficiency Scenarios in place of its current process for forecasting reasonably anticipated settlement obligations to determine whether to require additional cash deposits from its Clearing Members. These Sufficiency Scenarios may include a range of Historical and Hypothetical Scenarios, including but not limited to, a 1987 historical market event and a 2008 historical market event. OCC notes that the proposed change would involve assessing OCC's projected settlement obligations against OCC's Available Liquidity Resources as opposed to its committed liquidity facilities in order to fully account for the amount of cash committed to OCC beyond its liquidity facilities (e.g., the Clearing Fund Cash Requirement). The proposed change would allow OCC to more appropriately monitor its liquidity exposures under a variety of foreseeable stress scenarios, including the default of the Clearing Member Group that would generate the largest aggregate payment obligation to OCC in extreme but plausible market conditions, and to call for additional liquid resources in the form of cash deposits to ensure that OCC continues to maintain sufficient liquid resources to meet its settlement obligations with a high degree of confidence.

#### Required Cash Deposits

Under the proposed LRMF, OCC would produce projections of near-term potential liquidity demands using its Sufficiency Scenarios for each Clearing Member Group. In the event OCC

projects that a Clearing Member Group's projected liquidity demands exceed 80% of OCC's Available Liquidity Resources, FRM would initiate enhanced monitoring of the Clearing Member Group's liquidity demand. If any stressed liquidity demand from a Sufficiency Scenario is greater than, or equal to, 90% of Available Liquidity Resources, OCC may require the Clearing Member Group to post deposits or substitute collateral in the form of cash ("Required Cash Deposits") to supplement OCC's Available Liquidity Resources.<sup>46</sup> In addition, the proposed LRMF would establish other thresholds designed to monitor the impact of Required Cash Deposits on individual Clearing Members. Specifically, if a Required Cash Deposit for an individual Clearing Member exceeds \$500 million or 75% of the Clearing Member's excess net capital, STLRM would be required to notify the OCEO. If the Required Cash Deposit imposed on an individual Clearing Member would exceed 100% of an individual Clearing Member's net capital, the Required Cash Deposit shall be escalated to the OCEO, and any member of the OCEO would have the authority individually to determine whether OCC should continue calling for additional liquidity resources in excess of 100% of the net capital amount. OCC believes that this notification and escalation process would enable OCC to appropriately require those Clearing Members that bring elevated liquidity exposures to OCC to bear the costs of those risks in the form of Required Cash Deposits while also allowing OCC to take into consideration a particular Clearing Member's ability to meet the call based on its financial condition and the amount of collateral it has available to pledge when certain pre-identified thresholds have been exceeded.

These thresholds and any recommended changes thereto would be reviewed by the CLRWG and sent to the Risk Committee for approval during an annual review. Under the proposed LRMF, each member of OCC's Office of the Chief Executive Officer would maintain separate authority to approve temporary changes to the thresholds outside of the annual review process due to changing market or business

<sup>46</sup> The amount of any Required Cash Deposit would be determined by calculating the value of 90% of the total Available Liquidity Resources for the Clearing Member Group in question less amount of the largest stressed liquidity demand for that member resulting from OCC's Sufficiency Scenarios. Required Cash Deposits would be recalculated daily and remain in place until the projected demand no longer exceeds 90% of Available Liquidity Resources.

<sup>45</sup> See *supra* note 5.

conditions. Any temporary change in Contingency Funding Plan thresholds shall be reviewed by the Risk Committee within 20 calendar days of such increase to determine whether the increase was appropriate on a temporary basis, or whether OCC's Liquidity Risk Management Framework, stress testing methodology, Base Liquidity Resources, or Contingency Funding Plan should be modified to ensure that OCC continues to maintain sufficient liquidity resources to meet its regulatory obligations. Such a determination 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. If the Risk Committee determines that a permanent change is required to OCC's Liquidity Risk Management Framework, stress testing methodology, Base Liquidity Resources, or Contingency Funding Plan, OCC would continue to maintain any temporary changes in Contingency Funding Plan thresholds through the completion of any necessary regulatory filings to ensure that it maintains sufficient liquidity resources during the regulatory review and approval process.

Pursuant to procedures maintained by OCC's FRM department, a Clearing Member Group would be required to maintain a Required Cash Deposit in the account(s) where the demand is being generated until the stressed liquidity demand falls below established thresholds or until the settlement demand is met. OCC would generally require funding of Required Cash Deposits five business days before the date of the projected demand but may require funding up to 20 business days before the projected date as facts and circumstances may warrant.

#### Increases to Base Liquidity Resources

Under the proposed LRMF, the Contingency Funding Plan would also include increases in OCC's Base Liquidity Resources through an increase in the Clearing Fund Cash Requirement pursuant to proposed Rule 1002(a) as discussed above.<sup>47</sup> Additionally, OCC endeavors to have an uncommitted accordion<sup>48</sup> feature embedded in any syndicated credit facility, potentially allowing OCC to borrow additional funds from existing or new bank syndicate liquidity providers. The availability of an accordion is based on

the willingness and ability of the syndicate members to fund the additional borrowing request. OCC can initiate a request to utilize an accordion at any time and it can be expected that it would take a period of weeks to exercise this feature.

#### Changes to OCC's Rules

OCC proposes changes to Chapters VI (Margins) and X (Clearing Fund) of its Rules to implement the proposed enhancements to its Contingency Funding Plan. OCC proposes to adopt new Rule 601(g) and Rule 609(b) to provide that, in cases when OCC forecasts that a Clearing Member's potential settlement obligations, including potential settlement obligations under stressed market conditions, could be in excess of OCC's committed liquidity resources available to satisfy such obligations, OCC may impose Required Cash Deposits either as part of the Clearing Member's normal daily margin requirement under Rule 601 or through the deposit of intra-day margin in the form of cash under Rule 609. Proposed Rules 601(g) and 609(b) would also provide that OCC would generally require funding of Required Cash Deposits five business days before the date of the projected demand but may require funding up to 20 business days before the projected date as facts and circumstances may warrant. Rule 609(b) would further provide that any such deposit of intra-day margin must be satisfied within one hour of the issuance of an instruction debiting the applicable bank account of the Clearing Member unless the Clearing Member is notified by an officer of OCC of an alternative time to satisfy such obligation, which is generally consistent with OCC's current intra-day margin authority under Rule 609 (and newly amended Rule 609(a)). OCC believes the proposed changes would provide additional clarity and transparency around its authority to impose Required Cash Deposits.

OCC also proposes clarifying changes to Rule 608 concerning withdrawals of margin to provide that the existing prohibition on withdrawing margin for liquidity purposes would now be based on liquidity demands forecasted by OCC that may include potential settlement obligations under stressed market conditions. OCC also would adopt new Interpretation and Policy .08 to Rule 601 and amend Interpretation and Policy .02 to Rule 608 and Interpretation and Policy .01 to Rule 609 to clarify that, for purposes of determining whether a Clearing Member's forecasted settlement obligations to the Corporation could exceed the liquidity resources available

to satisfy such obligations, OCC would consider, as forecasted settlement obligations, the settlement obligations of the Clearing Member and any Member Affiliates of the Clearing Member, as well as consider as liquidity resources the margin assets remaining on deposit with respect to such accounts that are in the form of U.S. dollars.

#### 6. Required Cash Deposits for Clearing Members on Watch Level

In addition to the proposed enhancements to the Contingency Funding Plan discussed above, OCC proposes to add new Rule 604(g) to provide OCC with authority to require Clearing Members to deposit a specified amount of cash to satisfy its margin requirements as a protective measure if a Clearing Member is determined to present increased credit risk and is subject to enhanced monitoring and surveillance under OCC's watch level reporting process.<sup>49</sup> Under the proposed rule, Clearing Members may be required to satisfy such required cash deposits through their daily margin requirements under Rule 601 or through intra-day margin calls under Rule 609. The proposed rule change is designed to provide OCC with an additional tool to mitigate potential liquidity risks of those Clearing Members identified as presenting increased risk to OCC through its ongoing monitoring processes outside of the forecasting process in the Contingency Funding Plan.

#### 7. Enhancements to Rules Concerning the Borrowing of Clearing Fund Assets

Under Chapter X of OCC's Rules, OCC has authority in certain circumstances to take possession of cash or securities contributed to the Clearing Fund and to use such assets for borrowings. OCC also generally requires Clearing Members to collectively contribute a minimum of \$3 billion in cash to the Clearing Fund, which is intended to provide OCC with a reliable amount of qualifying liquid resources to account for the event that there is an extreme scenario in the financial markets and OCC has to address any resultant liquidity demands. In addition to providing OCC with sufficient pre-funded financial resources to cover potential credit losses, these Clearing Fund contributions serve as an important source of liquidity for OCC to manage potential liquidity risks associated with a Clearing Member default or the failure or operational disruption of a bank or securities or

<sup>47</sup> See *supra* notes 37–40 and associated text.

<sup>48</sup> An accordion is an uncommitted expansion of a credit facility generally on the same terms as a credit facility.

<sup>49</sup> OCC's watch level reporting process is outlined in its CCRM Policy. See *supra* note 18.

commodities clearing organization. OCC is proposing several changes to its rules to clarify its authority to borrow Clearing Fund contributions to address potential liquidity needs.

#### Authority To Borrow Cash Clearing Fund Contributions for Liquidity Purposes

OCC Rule 1006(f) describes OCC's use of the Clearing Fund for liquidity purposes, specifically, the use of Clearing Fund for borrowing or otherwise obtaining funds to be used for liquidity purposes. Rule 1006(f) primarily discusses the use of Clearing Fund securities to borrow or otherwise obtain funds from third parties to meet its settlement obligations; however, OCC would be unlikely to use Clearing Fund cash deposits to borrow collateral from a third party in the same, fungible form, incur costs associated with the borrowing, and then use that fungible collateral to meet OCC's obligations. Rather, OCC would directly borrow Clearing Fund cash under the same general terms and conditions as it would to effect a borrowing pursuant to Rule 1006(f). This is further reinforced by OCC's Default Management Policy, which provides that "[i]n order to meet financial resource obligations as a result of a clearing member suspension, OCC is able to utilize the following resources . . . *Clearing Fund deposits of the suspended member.* OCC may utilize any cash, convert Clearing Fund deposits to cash, or effect borrowing or other transactions using such deposits. *Clearing Fund deposits of non-defaulting members.* OCC may utilize any cash, convert Clearing Fund deposits to cash, or effect borrowing or other transactions using such deposits." (emphasis in original).<sup>50</sup>

OCC proposes to amend Rules 1006(a) and (f) to clarify that, where the Clearing Fund is already allowed to be used for borrowings, OCC has authority to borrow cash directly instead of pledging Clearing Fund cash or securities to a third party to borrow or otherwise obtain funds. Making this authority explicit will provide OCC with clear and transparent flexibility to access cash contributions to the Clearing Fund in relevant circumstances rather than pledging Clearing Fund securities to borrow on a secured basis. Consistent with OCC's current rules applicable to using Clearing Fund assets to effect borrowings, OCC would be permitted to borrow Clearing Fund cash directly for any means determined to be reasonable by the Executive Chairman, Chief Executive Officer, or Chief Operating

Officer in his discretion and shall not be deemed to be a charge against the Clearing Fund for a period not to exceed thirty days, and, during said period, shall not affect the amount or timing of any charges otherwise required to be made against the Clearing Fund pursuant to Chapter X of the Rules. OCC believes the proposed rule change would provide additional clarity and transparency to its Clearing Members regarding OCC's use of Clearing Fund cash as a liquidity resource and would help Clearing Members better understand their and OCC's rights and obligations as they relate to the Clearing Fund.

#### Authority To Reject Substitution Requests for Clearing Fund Collateral

OCC proposes to amend Rule 1006(f) to permit OCC to reject a Clearing Member's substitution request regarding a security contributed to the Clearing Fund where OCC has already used the security to borrow or otherwise obtain funds. OCC's current By-Laws and Rules do not explicitly address its right to reject a request by a Clearing Member to substitute Government Securities that have been pledged to its liquidity facilities; however, OCC's Rules provide it with plenary authority to use such securities for the purposes of borrowing from its liquidity facilities without restriction or limitation on OCC regarding any obligation or timing for making a substitution. Specifically, Rule 1006(f) provides OCC with broad authority to take possession of cash or securities deposited by Clearing Members as contributions to the Clearing Fund and use such assets to borrow or otherwise obtain funds, including through its committed liquidity facilities, to meet obligations arising out of the default or suspension of a Clearing Member, the failure of a bank or securities or commodities clearing organization to meet its obligations, or where OCC believes it necessary to borrow to meet its liquidity needs for same-day settlement as a result of the failure of any bank or securities or commodities clearing organization. Rule 1006(f) further provides OCC with the authority to pledge such cash and securities to borrow from its liquidity facilities for a period of up to thirty days.<sup>51</sup>

OCC proposes to amend Rule 1006(f) to explicitly permit OCC to reject a Clearing Member's substitution request

regarding a security contributed to the Clearing Fund where OCC has already used the security to borrow or otherwise obtain funds. OCC believes that providing this discretion will strengthen OCC's access to liquidity through secured borrowing arrangements by ensuring OCC is able to preserve the pledge of particular securities where necessary or appropriate.

#### Timeframe To Determine Losses Resulting From Borrowing

OCC Rule 1006(f) currently provides, in part, that funds obtained by OCC through a borrowing shall not be deemed to be charges against the Clearing Fund for a period not to exceed thirty days, and, during that period, shall not affect the amount or timing of any charges otherwise required to be made against the Clearing Fund; however, if all or a part of any transaction effected by OCC under Rule 1006(f) remains outstanding after thirty days, OCC shall consider the amount of Clearing Fund assets used to support its obligations under the outstanding transaction as an actual loss to the Clearing Fund and immediately allocate such loss in accordance with Chapter X of the Rules.

OCC proposes to amend Rule 1006(f) to clarify that OCC is not required to wait thirty days prior to determining that any borrowing represents an actual loss to the Clearing Fund. Making this authority more explicit will help ensure that OCC is able to make proportionate charges against Clearing Member contributions to the Clearing Fund in a timely manner to make good the related losses and replenish its credit and liquidity resources.

#### 8. Requirement for Clearing Members To Maintain Contingency Plans for Settlement

OCC Rule 301(d) currently requires that every Clearing Member have access to sufficient financial resources to meet obligations arising from clearing membership in extreme but plausible market conditions. OCC rules do not address circumstances in which a Clearing Member has sufficient resources to meet its obligations but is unable to meet settlement obligations due to, for example, a failure or operational issue at its primary settlement bank. As a result, OCC proposes to amend Rule 301(d) to further require that every Clearing Member maintain adequate procedures, including but not limited to contingency funding, to ensure that it is able to meet its obligations arising in connection with clearing membership when such obligations arise. OCC believes that it is

<sup>51</sup> OCC notes that while the terms of its committed liquidity facilities may generally permit OCC to substitute pledged collateral during the course of a borrowing, nothing in the agreements requires OCC to make such a substitution at the request of a Clearing Member.

<sup>50</sup> See *supra* note 6.

important that OCC and its members maintain processes that are resilient to a variety of potential operational and financial disruptions and that Clearing Members maintain robust contingency plans designed to effect timely settlement of their obligations to reduce the likelihood member would be unable to satisfy their settlement obligations, risking possible suspension. Examples of such arrangements could include maintaining ability to wire funds directly to OCC via Fedwire or by providing instructions to another bank to effect the movement of funds.

#### 9. Other Clarifying and Conforming Changes

OCC also proposes to make conforming changes to the OCC Risk Policies to replace references to OCC's Liquidity Risk Management Policy with references to the LRMF, align descriptions of OCC's liquidity risk management practices with the proposed LRMF, and make other non-substantive administrative changes to enhance the accuracy and clarity of the Risk Policies. In addition, OCC would revise the definition of Committed Liquidity Facilities to better align that term with (1) the discussion of such facilities in the LRMF and (2) the definition of "qualifying liquid resources" (as defined in Exchange Act Rule 17Ad-22(a)(14)).<sup>52</sup>

Finally, OCC proposes to revise the policy exception and violation reporting requirements in the Risk Policies and make other administrative updates to policy cross-references. OCC's Compliance Department is responsible for maintaining OCC's internal policy concerning the governance and content of OCC's policies and procedures. This includes the development of standard templates for OCC policy documentation and ensuring that those templates include appropriate and consistent requirements for the reporting and escalation of policy exceptions and violations. OCC proposes to revise the Risk Policies to incorporate new, standardized policy exception and violation reporting requirements, which apply to all internal OCC policies and procedures. The proposed change would simplify and centralize the escalation path for policy document owners and ensure that OCC's Compliance department, and if appropriate the Enterprise Risk Management department, is notified in a consistent manner of any exceptions or violations. OCC does not believe the proposed change would have a material impact on operations under the Risk

Policies. The proposed change is intended to ensure that the administration of policy exception and violation reporting is done in a consistent manner throughout OCC's policies.

#### Clearing Member Outreach

To inform Clearing Members of the proposed changes, OCC has provided an overview of the proposed changes to the Financial Risk Advisory Council ("FRAC"), a working group comprised of exchanges, Clearing Members and indirect participants of OCC and the OCC Roundtable, which was established to bring Clearing Members, exchanges and OCC together to discuss industry and operational issues.<sup>53</sup> OCC will also provide parallel testing prior to implementation and perform direct outreach to Clearing Members most likely to be materially impacted by the proposed changes and answer any questions Clearing Members may have. To-date, OCC has not received any material objections or concerns in response to this outreach.

#### Implementation Timeframe

OCC expects to implement the proposed changes within sixty (60) days after the date that OCC receives all necessary regulatory approvals for the proposed changes. OCC will announce the implementation date of the proposed change by an Information Memorandum posted to its public website at least two (2) weeks prior to implementation.

#### (2) Statutory Basis

OCC believes that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a registered clearing agency. In particular, OCC believes the proposed rule change is consistent with Section 17A(b)(3)(F) of the Act,<sup>54</sup> which requires, among other things, that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities and derivatives transactions, assure the safeguarding of securities and funds which are in its custody or control or for which it is responsible and, in general, protect investors and the public interest. OCC also believes the proposed rule change is reasonably designed to comply with relevant rules promulgated

under the Exchange Act, and in particular, Rule 17Ad-22(e)(7)<sup>55</sup> requirements concerning the measurement, monitoring, and management of liquidity risk.

#### 1. Liquidity Risk Management Framework

The proposed LRMF would set forth the manner in which OCC effectively measures, monitors, and manages its liquidity risks, including how OCC measures, monitors, and manages its settlement and funding flows on an ongoing and timely basis, and its use of intraday liquidity. Specifically, the LRMF would describe: (1) The identification of OCC's liquidity risks; (2) the categories and types of OCC's liquidity resources; (3) the stress testing and sizing of OCC's liquidity resources; (4) OCC's Contingency Funding Plan for collecting additional liquidity resources from Clearing Members; (5) the risk management of supporting institutions (e.g., settlement banks, custodian banks, and liquidity providers) that may present liquidity risks to OCC; and (6) the governance and reporting requirements concerning OCC's LRMF. Taken together, the proposed LRMF is designed to ensure that OCC comprehensively manages its liquidity risks and maintains sufficient liquid resources to allow OCC to continue the prompt and accurate clearance and settlement of securities and assure the safeguarding of securities and funds which are in its custody or control or for which it is responsible, notwithstanding a default of the Clearing Member Group that would generate the largest aggregate payment obligation for OCC in extreme but plausible market conditions. The proposed LRMF would thereby enhance OCC's resilience as a systemically important financial market utility, which in turn would promote the protection of investors and the public interest. Therefore, OCC believes the proposed LRMF is consistent with the requirements of Section 17A(b)(3)(F) of the Act.<sup>56</sup>

Rule 17Ad-22(e)(7)<sup>57</sup> requires generally that a covered clearing agency ("CCA") 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 the CCA, including measuring, monitoring, and managing its settlement and funding flows on an ongoing and timely basis, and its use of intraday liquidity. The proposed LRMF

<sup>53</sup> The OCC Roundtable is comprised of representatives of the senior OCC staff, participant exchanges and Clearing Members, representing the diversity of OCC's membership in industry segments, OCC-cleared volume, business type, operational structure and geography.

<sup>54</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>55</sup> 17 CFR 240.17Ad-22(e)(7).

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

<sup>57</sup> 17 CFR 240.17Ad-22(e)(7).

<sup>52</sup> 17 CFR 240.17Ad-22(a)(14).

would describe OCC's overall framework for effectively measuring, monitoring, and managing its liquidity risks, including how OCC measures, monitors, and manages its settlement and funding flows on an ongoing and timely basis, and its use of intraday liquidity. The proposed LRMF would govern OCC's policies and procedures as they relate to liquidity risk management, including any policies and procedures concerning: (1) The identification of OCC's liquidity risks; (2) the categories and types of OCC's liquidity resources; (3) the stress testing and sizing of OCC's liquidity resources; (4) OCC's Contingency Funding Plan for collecting additional liquidity resources from Clearing Members; (5) the risk management of supporting institutions (e.g., settlement banks, custodian banks, and liquidity providers) that may present liquidity risks to OCC; and (6) the governance and reporting requirements concerning OCC's LRMF. OCC therefore believes the proposed LRMF is reasonably designed to comply with the requirements of Rule 17Ad-22(e)(7).<sup>58</sup>

Rules 17Ad-22(e)(7)(i) and (ii)<sup>59</sup> require a CCA to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain sufficient liquid resources at the minimum in all relevant currencies to effect same-day and, where appropriate, intraday and multiday settlement of payment obligations with a high degree of confidence under a wide range of foreseeable stress scenarios that includes but is not limited to, the default of the participant family that would generate the largest aggregate payment obligation for the CCA in extreme but plausible market conditions and to maintain such resources in the form of qualifying liquid resources and in each relevant currency for which the CCA has payment obligations owed to clearing members. The proposed LRMF would describe: (1) OCC's approach to liquidity stress testing; (2) OCC's process for determining the size of OCC's liquidity resources based on analyses of projected liquidity demands under a variety of stress scenarios (e.g., stress scenarios representing OCC's liquidity risk tolerance, extreme historical scenarios such as a 1987 historical market event and 2008 historical market event, and certain scenarios used to size OCC's Clearing Fund); (3) OCC's process for testing the sufficiency of its liquidity resources and Contingency Funding Plan for collecting

additional liquidity resources when necessary; and (4) the various categories and types of liquidity resources maintained by OCC, including the qualifying liquid resources maintained by OCC to meet its minimum liquidity resource requirement for effecting same-day, intraday and multiday settlement of OCC's payment obligations. OCC therefore believes the proposed LRMF is reasonably designed to comply with the requirements of Rules 17Ad-22(e)(7)(i) and (ii).<sup>60</sup>

Rule 17Ad-22(e)(7)(iii)<sup>61</sup> requires that a CCA establish, implement, maintain and enforce written policies and procedures reasonably designed to use access to accounts and services at a Federal Reserve Bank, or other relevant central bank, when available and where determined to be practical by the board of directors of the CCA, to enhance its management of liquidity risk. The proposed LRMF would describe OCC's use of accounts and services at the Federal Reserve Bank of Chicago in accordance with this requirement.

Rules 17Ad-22(e)(7)(iv) and (v)<sup>62</sup> require that a CCA establish, implement, maintain and enforce written policies and procedures reasonably designed to: (1) Undertake due diligence to confirm that it has a reasonable basis to believe each of its liquidity providers has sufficient information to understand and manage the liquidity provider's liquidity risks and the capacity to perform as required under its commitments to provide liquidity to the CCA and (2) maintain and test with each liquidity provider, to the extent practicable, the CCA's procedures and operational capacity for accessing each type of relevant liquidity resource at least annually. The proposed LRMF would set forth OCC's requirements for performing due diligence to confirm it has a reasonable basis to believe each of its liquidity providers has sufficient information to understand and manage OCC's liquidity risk profile and the capacity to perform as required under its commitments. The proposed LRMF would also require the execution of periodic test borrows no less than once every 12 months to measure the performance and reliability of the liquidity facilities. As a result, OCC believes the proposed LRMF is consistent with Rules 17Ad-22(e)(7)(iv) and (v).<sup>63</sup>

Rule 17Ad-22(e)(7)(vi)(A)<sup>64</sup> requires that a CCA establish, implement,

maintain and enforce written policies and procedures reasonably designed to determine the amount and regularly test the sufficiency of the liquid resources held for purposes of meeting the minimum liquid resource requirement by conducting stress testing of its liquidity resources at least once each day using standard and predetermined parameters and assumptions. Under the proposed LRMF, OCC would perform daily stress tests using its Sufficiency Scenarios to assess potential liquidity exposures in excess of OCC's Available Liquidity Resources under a range of stress scenarios, including but not limited to, a 1987 historical market event and a 2008 historical market event, and if a Clearing Member Group's exposures breach certain thresholds, OCC would require the breaching Clearing Member Group to maintain cash deposits in lieu of other forms of acceptable collateral to supplement OCC's Available Liquidity Resources pursuant to the Contingency Funding Plan.<sup>65</sup> OCC therefore believes that the proposed LRMF is reasonably designed to comply with the requirements of Rule 17Ad-22(e)(7)(vi)(A).<sup>66</sup>

Rules 17Ad-22(e)(7)(vi)(B)-(D)<sup>67</sup> further require a CCA to maintain policies and procedures for: (1) Conducting a comprehensive analysis on at least a monthly basis of the existing stress testing scenarios, models, and underlying parameters and assumptions used in evaluating liquidity needs and resources, and considering modifications to ensure they are appropriate for determining the clearing agency's identified liquidity needs and resources in light of current and evolving market conditions; (2) conducting a comprehensive analysis more frequently than monthly when the products cleared or markets served display high volatility or become less liquid, when the size or concentration of positions held by the clearing agency's participants increases significantly, or in other appropriate circumstances described in such policies and procedures; and (3) reporting the results of such analyses to appropriate decision makers at the CCA, including but not limited to, its risk management committee or board of directors, and using these results to evaluate the adequacy of and adjust its liquidity risk management methodology, model parameters, and any other relevant

<sup>58</sup> *Id.*  
<sup>59</sup> 17 CFR 240.17Ad-22(e)(7)(i) and (ii).  
<sup>60</sup> *Id.*  
<sup>61</sup> 17 CFR 240.17Ad-22(e)(7)(iii).  
<sup>62</sup> 17 CFR 240.17Ad-22(e)(7)(iv) and (v).  
<sup>63</sup> *Id.*  
<sup>64</sup> 17 CFR 240.17Ad-22(e)(7)(vi)(A).  
<sup>65</sup> OCC also would perform daily stress tests using Adequacy and Informational Scenarios to evaluate the sufficiency of its liquidity resources under a wide range of historical and hypothetical stress scenarios.  
<sup>66</sup> 17 CFR 240.17Ad-22(e)(7)(vi)(A).  
<sup>67</sup> 17 CFR 240.17Ad-22(e)(7)(vi)(B)-(D).

aspects of its liquidity risk management framework. The proposed LRMF would set forth the governance, review, monitoring, and reporting activities performed by OCC with respect to liquidity risk management. This would include the comprehensive review of existing stress test results and scenarios, and their underlying parameters and assumptions, the output of which is used to project liquidity demands, and evaluation of their appropriateness for determining the level of liquidity resources that OCC must maintain under current and evolving market conditions, with such an analysis being conducted more frequently than monthly when products cleared or markets served display high volatility or become less liquid, or when the size or concentration of positions held by OCC's participants increases significantly. In addition, under the proposed LRMF, FRM would be responsible for preparing a summary of the adequacy of OCC's Base Liquidity Resources and results from its monthly comprehensive review to provide to OCC's Management Committee and Risk Committee and any issues would be promptly escalated to OCC's Management Committee intra-month when circumstance warrant. Accordingly, OCC believes that the proposed LRMF is reasonably designed to comply with the requirements of Rules 17Ad-22(e)(7)(vi)(B)–(D).<sup>68</sup>

## 2. Liquidity Stress Testing

OCC proposes to adopt a liquidity stress testing approach to effectively measure and monitor the sufficiency of OCC's liquidity resources. OCC would perform daily liquidity risk stress testing using standard and predetermined parameters and assumptions, and the output of these scenarios would be used for liquidity resource evaluation. OCC's proposed liquidity stress tests would consist of a range of Historical and Hypothetical Scenarios, and the output would be used to: (1) Assess OCC's projected liquidity demands under stressed scenarios against OCC's Base and Available Liquidity Resources; (2) assess OCC's liquidity resources against OCC's liquidity risk tolerance; (3) measure the sufficiency of potential exposures in excess of OCC's liquidity resources to determine if additional risk mitigation is needed when those exposures indicate potential breaches in scenarios including but not limited to, a 1987 historical market event and a 2008 historical market event; and (4) monitor and assess OCC's liquidity resources

under a variety of stress conditions, which may include extreme but implausible scenarios and reverse stress test scenarios. The proposed change is designed to ensure that OCC comprehensively manages its liquidity risks and maintains sufficient liquid resources to allow OCC to continue the prompt and accurate clearance and settlement of securities and assure the safeguarding of securities and funds which are in its custody or control or for which it is responsible, notwithstanding a default of the Clearing Member Group that would generate the largest aggregate payment obligation for OCC in extreme but plausible market conditions. The proposed rule change would thereby enhance OCC's resilience as a systemically important financial market utility, which in turn would promote the protection of investors and the public interest. Therefore, OCC believes the proposed change is consistent with the requirements of Section 17A(b)(3)(F) of the Act.<sup>69</sup>

Rule 17Ad-22(e)(7)(i)<sup>70</sup> requires a CCA to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain sufficient liquid resources at the minimum in all relevant currencies to effect same-day and, where appropriate, intraday and multiday settlement of payment obligations with a high degree of confidence under a wide range of foreseeable stress scenarios that includes but is not limited to, the default of the participant family that would generate the largest aggregate payment obligation for the CCA in extreme but plausible market conditions. Rule 17Ad-22(e)(7)(vi)(A)<sup>71</sup> further requires that a CCA establish, implement, maintain and enforce written policies and procedures reasonably designed to determine the amount and regularly test the sufficiency of the liquid resources held for purposes of meeting the minimum liquid resource requirement by conducting stress testing of its liquidity resources at least once each day using standard and predetermined parameters and assumptions. As described above, OCC's proposed liquidity stress tests would consist of a range of Historical and Hypothetical Scenarios, the output of which would be used to: (1) Assess OCC's projected liquidity demands under stressed scenarios against OCC's Base and Available Liquidity Resources; (2) assess OCC's liquidity resources against OCC's liquidity risk tolerance; (3) measure the sufficiency of potential

exposures in excess of OCC's liquidity resources to determine if additional risk mitigation is needed when those exposures indicate potential breaches in scenarios including but not limited to, a 1987 historical market event and a 2008 historical market event; and (4) monitor and assess OCC's liquidity resources under a variety of stress conditions, which may include extreme but implausible scenarios and reverse stress test scenarios. The proposed change is designed to ensure that OCC maintains sufficient liquid resources to settle its payment obligations with a high degree of confidence under a wide range of foreseeable stress scenarios that includes but is not limited to, the default of the Clearing Member Group that would generate the largest aggregate payment obligation for in extreme but plausible market conditions. It would also allow OCC to conduct daily sufficiency stress tests to assess potential liquidity exposures in excess of its Available Liquidity Resources under a range of stress scenarios, including but not limited to, a 1987 historical market event and a 2008 historical market event, and if a Clearing Member Group's exposures breach certain thresholds, OCC would require the breaching Clearing Member Group to maintain cash deposits in lieu of other forms of acceptable collateral to supplement OCC's Available Liquidity Resources pursuant to the Contingency Funding Plan.<sup>72</sup> OCC therefore believes that the proposed LRMF is reasonably designed to comply with the requirements of Rule 17Ad-22(e)(7)(i) and (e)(vi)(A).<sup>73</sup>

## 3. Clearing Fund Cash Requirement

The proposed changes to OCC's Clearing Fund Cash Requirement are designed to improve the resiliency of OCC's liquidity resources by providing OCC with the flexibility to periodically set its Base Liquidity Resources and to adjust Base Liquidity Resources in response to changing market and business conditions to ensure that OCC maintains sufficient liquidity resources to cover its potential liquidity risk exposures so that it can continue to meet its settlement obligations in a timely manner. Specifically, the proposed changes would provide OCC's Risk Committee with the authority to initially reset the Clearing Fund Cash Requirement to \$3.5 billion based on an analysis of stress test results

<sup>72</sup> OCC also would perform daily stress tests using Adequacy and Informational Scenarios to evaluate the sufficiency of its liquidity resources under a wide range of historical and hypothetical stress scenarios.

<sup>73</sup> 17 CFR 240.17Ad-22(e)(7)(i) and (e)(vi)(A).

<sup>68</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>70</sup> 17 CFR 240.17Ad-22(e)(7)(i).

<sup>71</sup> 17 CFR 240.17Ad-22(e)(7)(vi)(A).

<sup>69</sup> *Id.*



demonstrating that this amount, in combination with OCC's committed liquidity facilities, should be sufficient to cover OCC's liquidity risk tolerance of a 1-in-50 year statistical market event at a 99.5% confidence level over a two-year look back period<sup>74</sup> and to further adjust OCC's Base Liquidity Resources based on future stress test results in a more timely manner. It would also allow OCC's executive management team to adjust OCC's Base Liquidity Resources on a temporary basis, subject to notification and review by the Risk Committee, in response to changing market and business conditions. For these reasons, OCC believes the proposed changes are designed to promote the prompt and accurate clearance and settlement of securities and derivatives transactions, assure the safeguarding of securities and funds which are in its custody or control or for which it is responsible and, in general, protect investors and the public interest consistent with Section 17A(b)(3)(F) of the Act.<sup>75</sup>

Additionally, Rule 17Ad-22(e)(7)(i)<sup>76</sup> requires that a CCA establish, 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, including 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 stressed liquidity demands, including Adequacy Scenarios that demonstrate that its potential stressed liquidity demands may exceed the size OCC's committed liquidity facilities and current Cash Clearing Fund Requirement. The proposed changes would allow OCC to adjust its Base 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 changes concerning the Clearing Fund Cash Requirement are designed to

satisfy the requirements of Rule 17Ad-22(e)(7)(i).<sup>77</sup>

Further, Rule 17Ad-22(e)(7)(viii)<sup>78</sup> requires that a CCA address foreseeable liquidity shortfalls that would not be covered by its liquid resources and Rule 17Ad-22(e)(7)(ix)<sup>79</sup> requires that a CCA describe its process to replenish any liquid resources that it may employ during a stress event. OCC believes that additional flexibility for temporarily increasing the Clearing Fund Cash Requirement up to an amount that includes the size of the Clearing Fund 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 OCC Rule 1006(h), to the extent that Clearing Members are required to replenish their required contributions—in whole or in part—with cash following a proportionate charge, the proposed change would provide a form of replenishment of OCC's liquid resources. In this regard, OCC believes the proposed change is consistent with the requirements of Rules 17Ad-22(e)(7)(viii) and (ix).<sup>80</sup>

#### 4. Two-Day Notice Period for Substitutions Involving Excess Clearing Fund Cash

OCC proposes to introduce a two-day notice period for any Clearing Member requesting to substitute Government Securities for cash deposits in excess of such Clearing Member's proportionate share of the Clearing Fund Cash Requirement. The proposed rule change is intended to provide additional certainty around the level of liquidity resources available to OCC at any given time by fixing the amount of cash in the Clearing Fund, and thereby fixing the amount of OCC's Available Liquid Resources, for any given two-day liquidation horizon.<sup>81</sup> The proposed change would enhance OCC's management of liquidity risk by providing additional certainty around its liquidity resource calculations and thereby help to ensure that OCC maintains sufficient liquidity resources to continue the prompt and accurate clearance and settlement of securities and assure the safeguarding of securities

and funds which are in its custody or control or for which it is responsible in the event of a default of the Clearing Member Group that would generate the largest aggregate payment obligation for OCC in extreme but plausible market conditions. The proposed change would thereby enhance OCC's resilience as a systemically important financial market utility, which in turn would promote the protection of investors and the public interest. Therefore, OCC believes the proposed rule change is consistent with the requirements of Section 17A(b)(3)(F) of the Act.<sup>82</sup>

Rules 17Ad-22(e)(7)(i) and (ii)<sup>83</sup> require a CCA to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain sufficient liquid resources at the minimum in all relevant currencies to effect same-day and, where appropriate, intraday and multiday settlement of payment obligations with a high degree of confidence under a wide range of foreseeable stress scenarios that includes but is not limited to, the default of the participant family that would generate the largest aggregate payment obligation for the CCA in extreme but plausible market conditions and to maintain such resources in the form of qualifying liquid resources and in each relevant currency for which the CCA has payment obligations owed to clearing members. The proposed change would provide additional certainty around the level of OCC's Available Liquidity Resources (which would be comprised of qualifying liquid resources) for any given two-day liquidation horizon, thereby enhancing OCC's ability to ensure that it maintains sufficient qualifying liquid resources to effect settlement of its payment obligations with a high degree of confidence under a wide range of foreseeable 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. OCC therefore believes the proposed change is consistent with the requirements of Rules 17Ad-22(e)(7)(i) and (ii).<sup>84</sup>

#### 5. Contingency Funding Plan

The proposed enhancements to the Contingency Funding Plan would include the use of certain Sufficiency Scenarios designed to assess potential liquidity exposures in excess of OCC's Available Liquidity Resources in place

<sup>74</sup> See *supra* note 38.

<sup>75</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>76</sup> 17 CFR 240.17Ad-22(e)(7)(i).

<sup>77</sup> *Id.*

<sup>78</sup> 17 CFR 240.17Ad-22(e)(7)(viii).

<sup>79</sup> 17 CFR 240.17Ad-22(e)(7)(ix).

<sup>80</sup> 17 CFR 240.17Ad-22(e)(7)(viii) and (ix).

<sup>81</sup> OCC notes that Clearing Members would continue to be able to immediately withdraw cash deposits that are above their Clearing Fund Cash Requirement provided that they have equivalent amount of excess Clearing Fund deposits (as provided under Rule 1008).

<sup>82</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>83</sup> 17 CFR 240.17Ad-22(e)(7)(i) and (ii).

<sup>84</sup> *Id.*

of OCC's current process for forecasting reasonably anticipated settlement obligations to determine whether to require additional cash deposits from its Clearing Members. The proposed changes would allow OCC to more appropriately monitor its liquidity exposures under a variety of foreseeable stress scenarios, and to call for additional liquid resources in the form of cash deposits to ensure that OCC continues to maintain sufficient liquid resources to meet its settlement obligations with a high degree of confidence, or to respond to a reduction in the amount of OCC's Base Liquidity Resources in an extreme event, such as the potential failure of a liquidity provider. OCC's Contingency Funding Plan is designed to enable OCC to meet its settlement obligations in all relevant currencies when OCC experiences or projects a liquidity shortfall exceeding its financial resources without unwinding, revoking, or delaying same-day and where appropriate, intraday and multiday, settlement obligations. The proposed changes are designed to ensure that OCC comprehensively manages its liquidity risks and maintains sufficient liquid resources to allow OCC to continue the prompt and accurate clearance and settlement of securities and assure the safeguarding of securities and funds which are in its custody or control or for which it is responsible. The proposed changes would thereby enhance OCC's resilience as a systemically important financial market utility, which in turn would promote the protection of investors and the public interest. As a result, OCC believes the proposed changes are consistent with the requirements of Section 17A(b)(3)(F) of the Act.<sup>85</sup>

Rule 17Ad-22(e)(7)(vi)(A)<sup>86</sup> requires that a CCA establish, implement, maintain and enforce written policies and procedures reasonably designed to determine the amount and regularly test the sufficiency of the liquid resources held for purposes of meeting the minimum liquid resource requirement by conducting stress testing of its liquidity resources at least once each day using standard and predetermined parameters and assumptions. Further, Rule 17Ad-22(e)(7)(viii)<sup>87</sup> requires such policies and procedures to address foreseeable liquidity shortfalls that would not be covered by the CCA's liquid resources and seek to avoid unwinding, revoking, or delaying the same-day settlement of payment obligations. Under the proposed LRMF

and changes to the Contingency Funding Plan, OCC would perform daily stress tests using its Sufficiency Scenarios to assess potential liquidity exposures in excess of OCC's Available Liquidity Resources under a range of stress scenarios, including but not limited to, a 1987 historical market event and a 2008 historical market event, and if a Clearing Member Group's exposures breach certain thresholds, OCC would require the breaching Clearing Member Group to maintain cash deposits in lieu of other forms of acceptable collateral to supplement OCC's Available Liquidity Resources pursuant to the Contingency Funding Plan. Accordingly, the Contingency Funding Plan enhancements also allow OCC to address foreseeable liquidity shortfalls that would not be covered by its currently available liquid resources. OCC therefore believes that the proposed LRMF and changes to the Contingency Funding Plan are reasonably designed to comply with the requirements of Rules 17Ad-22(e)(7)(vi)(A) and 17Ad-22(e)(7)(viii).<sup>88</sup>

#### 6. Required Cash Deposits for Clearing Members on Watch Level

OCC proposes to add new Rule 604(g) to provide OCC with authority to require Clearing Members to deposit a specified amount of cash to satisfy its margin requirements as a protective measure if a Clearing Member is determined to present increased credit risk and is subject to enhanced monitoring and surveillance under OCC's watch level reporting process. Under the proposed rule, Clearing Members may be required to satisfy such required cash deposits through their daily margin requirements under Rule 601 or through intra-day margin calls under Rule 609. The proposed rule change is designed to provide OCC with an additional tool to mitigate potential liquidity risks of those Clearing Members identified as presenting increased risk to OCC through its ongoing monitoring processes outside of the forecasting process in the Contingency Funding Plan. The proposed change would allow OCC to collect additional liquid resources from a Clearing Member demonstrating potentially increasing levels of risk through the watch level review process so that OCC can continue the prompt and accurate clearance and settlement of securities and assure the safeguarding of securities and funds which are in its custody or control or for which it is

responsible in the event such Clearing Member defaults. The proposed change is therefore designed to enhance OCC's resilience as a systemically important financial market utility, which in turn would promote the protection of investors and the public interest. As a result, OCC believes the proposed change is consistent with the requirements of Section 17A(b)(3)(F) of the Act.<sup>89</sup>

Additionally, Rule 17Ad-22(e)(7)<sup>90</sup> requires generally that a CCA establish, 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. OCC believes that the proposed change is reasonably designed to comply with the requirements of Rule 17Ad-22(e)(7)<sup>91</sup> because it would provide OCC with an additional tool to manage potential liquidity risks of those Clearing Members identified as presenting increased risk to OCC through its ongoing monitoring processes.

#### 7. Enhancements to Rules Concerning the Borrowing of Clearing Fund Assets

OCC is proposing several changes to its rules to clarify its authority to use Clearing Fund assets to address potential liquidity needs. First, OCC proposes to amend Rules 1006(a) and (f) to clarify that, where the Clearing Fund is already allowed to be used for borrowings, OCC has authority to borrow cash directly instead of pledging Clearing Fund cash or securities to a third party to borrow or otherwise obtain funds. The proposed change would provide additional clarity and transparency to OCC's Clearing Members regarding OCC's use of Clearing Fund cash as a liquidity resource and would help Clearing Members better understand their and OCC's rights and obligations as they relate to the Clearing Fund.<sup>92</sup> Second, OCC proposes to amend Rule 1006(f) to permit OCC to reject a Clearing

<sup>89</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>90</sup> 17 CFR 240.17Ad-22(e)(7).

<sup>91</sup> *Id.*

<sup>92</sup> OCC notes that the proposed changes to Rule 1006 are aligned with OCC's existing Default Management Policy, which provides that "[i]n order to meet financial resource obligations as a result of a clearing member suspension, OCC is able to utilize the following resources . . . *Clearing Fund deposits of the suspended member.* OCC may utilize any cash, convert Clearing Fund deposits to cash, or effect borrowing or other transactions using such deposits. *Clearing Fund deposits of non-defaulting members.* OCC may utilize any cash, convert Clearing Fund deposits to cash, or effect borrowing or other transactions using such deposits." (emphasis in original). See *supra* note 50 and associated text.

<sup>85</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>86</sup> 17 CFR 240.17Ad-22(e)(7)(vi)(A).

<sup>87</sup> 17 CFR 240.17Ad-22(e)(7)(viii).

<sup>88</sup> 17 CFR 240.17Ad-22(e)(7)(vi)(A) and (e)(7)(viii).

Member's collateral substitution request concerning a security contributed to the Clearing Fund where OCC has already used the security to borrow or otherwise obtain funds. Explicitly providing this discretion in OCC's Rules will strengthen OCC's access to liquidity through secured borrowing arrangements by ensuring OCC is able to preserve the pledge of particular securities where necessary or appropriate. Finally, OCC proposes to amend Rule 1006(f) to clarify that OCC is not required to wait thirty days prior to determining that any borrowing represents an actual loss to the Clearing Fund. Making this authority more explicit will help ensure that OCC is able to make proportionate charges against Clearing Member contributions to the Clearing Fund in a timely manner and make good the related losses. OCC believes that these proposed changes provide important clarity around its ability to borrow and use Clearing Fund assets for liquidity risk management purposes, and to replenish such resources in a timely fashion, thereby helping to promote the prompt and accurate clearance and settlement of securities and funds which are in its custody or control or for which it is responsible in the event such Clearing Member defaults. The proposed change is therefore designed to enhance OCC's resilience as a systemically important financial market utility, which in turn would promote the protection of investors and the public interest. As a result, OCC believes the proposed rule change is consistent with the requirements of Section 17A(b)(3)(F) of the Act.<sup>93</sup>

Rule 17Ad-22(e)(7)<sup>94</sup> requires generally that a CCA establish, 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)(ix)<sup>95</sup> further requires such policies and procedures to describe the CCA's process to replenish any liquid resources that the clearing agency may employ during a stress event. OCC believes that these proposed changes are reasonably designed to provide important clarity around its ability to borrow and use Clearing Fund assets for liquidity risk management purposes, and to replenish such resources in a timely fashion, in a

manner consistent with Rules 17Ad-22(e)(7) and (e)(7)(ix).<sup>96</sup>

#### 8. Requirement for Clearing Members to Maintain Contingency Plans for Settlement

OCC proposes to amend Rule 301(d) to require that every Clearing Member maintain adequate procedures, including but not limited to contingency funding, to ensure that it is able to meet its obligations arising in connection with clearing membership when such obligations arise. The proposed rule change is intended to reduce liquidity risk at OCC by requiring that Clearing Members have adequate contingency planning designed to effect timely settlement of their obligations with OCC despite a disruption by their primary settlement bank. OCC believes that it is important that OCC and its members maintain processes that are resilient to a variety of potential operational and financial disruptions and that Clearing Members maintain robust contingency plans designed to effect timely settlement of their obligations to reduce the likelihood member would be unable to satisfy its settlement obligations, risking possible suspension. As a result, OCC believes the proposed rule change would promote the prompt and accurate clearance and settlement of securities and funds which are in its custody or control or for which it is responsible in accordance with Section 17A(b)(3)(F) of the Act.<sup>97</sup>

Rule 17Ad-22(e)(18)<sup>98</sup> requires, in part, that a CCA establish, implement, maintain and enforce written policies and procedures reasonably designed to establish objective, risk-based, and publicly disclosed criteria for participation, which permit fair and open access by participants and, require participants to have sufficient financial resources and robust operational capacity to meet obligations arising from participation in the clearing agency. OCC believes the proposed amendments to Rule 301(d) are objective and risk-based in that they would apply to all Clearing Members and are intended to reduce the likelihood that a Clearing Member would be unable to satisfy their settlement obligations to OCC by requiring that Clearing Members have adequate contingency plans for financial resources and robust operational capacity to meet such obligations. The proposed requirement would also be publicly disclosed in OCC's Rules. OCC therefore believes the proposed change

is consistent with Rule 17Ad-22(e)(18).<sup>99</sup>

#### 9. Other Clarifying and Conforming Changes

OCC proposes to make a number of other clarifying, conforming, and organizational changes to the OCC Rules and Risk Policies to ensure the accuracy and consistency of its liquidity risk management rules and practices. The proposed changes are therefore designed to ensure that OCC is able to effectively manage its liquidity risks and maintain sufficient liquid resources to allow OCC to continue the prompt and accurate clearance and settlement of securities and funds which are in its custody or control or for which it is responsible, notwithstanding a default of the Clearing Member Group that would generate the largest aggregate payment obligation for OCC in extreme but plausible market conditions. As a result, OCC believes the proposed changes are consistent with the requirements of Section 17A(b)(3)(F) of the Act<sup>100</sup> and Rule 17Ad-22(e)(7) thereunder.<sup>101</sup>

In addition, Rules 17Ad-22(e)(2)(i) and (v)<sup>102</sup> require each covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for governance arrangements that are clear and transparent and specify clear and direct lines of responsibility. As discussed above, OCC would revise its Risk Policies to incorporate standardized policy exception and violation reporting requirements, which would apply to all internal OCC policies and procedures. The proposed change would simplify and centralize the escalation path for policy document owners and ensure that OCC's Compliance department, and if appropriate the Enterprise Risk Management department, is notified in a consistent manner of any exceptions or violations. OCC therefore believes the proposed rule change is consistent with Rule 17Ad-22(e)(2)(i) and (v).<sup>103</sup>

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

Section 17A(b)(3)(I) of the Act<sup>104</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. While aspects of

<sup>99</sup> *Id.*

<sup>100</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>101</sup> 17 CFR 240.17Ad-22(e)(7).

<sup>102</sup> 17 CFR 240.17Ad-22(e)(2)(i) and (v).

<sup>103</sup> *Id.*

<sup>104</sup> 15 U.S.C. 78q-1(b)(3)(I).

<sup>93</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>94</sup> 17 CFR 240.17Ad-22(e)(7).

<sup>95</sup> 17 CFR 240.17Ad-22(e)(7)(ix).

<sup>96</sup> 17 CFR 240.17Ad-22(e)(7) and (e)(7)(ix).

<sup>97</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>98</sup> 17 CFR 240.17Ad-22(e)(18).

the proposal would have an impact on certain Clearing Members, specifically in terms of the amount of cash Clearing Members must deposit at OCC in connection with potential liquidity obligations, OCC does not believe that the proposed rule change would impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. The potential impact on Clearing Members, and the appropriateness of those changes to further the purposes of the Act, is described in detail below.

#### 1. Liquidity Risk Management Framework

OCC does not believe that the adoption of the LRMF would have any impact, or impose any burden, on competition. The proposed LRMF would set forth the manner in which OCC effectively measures, monitors, and manages its liquidity risks, including how OCC measures, monitors, and manages its settlement and funding flows on an ongoing and timely basis, and its use of intraday liquidity. The LRMF is an internal OCC document intended to comprehensively describe OCC's liquidity risk management practices, many of which are current practices of OCC; however, to the extent changes in any of OCC's current practices would impact competition (e.g., changes in the Contingency Funding Plan), those impacts are addressed below. OCC believes that the adoption of the LRMF would not affect Clearing Members' access to OCC's services or disadvantage or favor any particular user in relationship to another user.

#### 2. Liquidity Stress Testing

The proposed liquidity stress testing approach is designed to allow OCC to more appropriately measure, monitor, and manage its liquidity exposures under a variety of foreseeable stress scenarios, including the default of the Clearing Member Group that would generate the largest aggregate payment obligation to OCC in extreme but plausible market conditions. OCC would perform daily stress testing using standard and predetermined parameters and assumptions. The proposed approach to liquidity stress testing would rely on the stressed scenarios and prices generated under OCC's current stress testing and Clearing Fund methodology.<sup>105</sup> The scenarios used are pre-identified by OCC's the STWG and the output of these scenarios would be used for liquidity resource evaluation and would be reviewed daily by FRM.

The stress tests in question consider a range of relevant stress scenarios and possible price changes in liquidation periods, including but not limited to: (1) Relevant peak historic price volatilities; (2) shifts in other market factors including, as appropriate, price determinants and yield curves; (3) the default of one or multiple members; (4) forward-looking stress scenarios; and (5) reverse stress tests aimed at identifying extreme default scenarios and extreme market conditions for which the OCC's resources would be insufficient. OCC believes the proposed approach to liquidity stress testing is designed to appropriately measure and allow OCC to monitor and manage its liquidity risk. It would also provide for new stress scenarios to be used by OCC to call for additional liquid resources in the form of cash deposits from those Clearing Members driving OCC's largest liquidity demands to ensure that OCC continues to maintain sufficient liquid resources to meet its settlement obligations with a high degree of confidence. While the proposed rule change could result in OCC requiring an increased amount of cash deposits from its Clearing Members, either in the form of margin or Clearing Fund, OCC believes the proposed changes are necessary for OCC to maintain compliance with its regulatory obligations under the Exchange Act and Rule 17Ad-22(e)(7) thereunder, as discussed in detail above. OCC therefore believes that any impact on competition or OCC's Clearing Members would be necessary and appropriate in furtherance of the protection of investors and the public interest under the Act. In any event, OCC does not believe the proposed rule change would affect Clearing Members' access to OCC's services or disadvantage or favor any particular user in relationship to another user.

#### 3. Clearing Fund Cash Requirement

OCC does not believe the proposed changes to the Clearing Fund Cash Requirement would have any impact, or impose any burden, on competition. The primary purpose of the proposed rule change is to provide OCC with the flexibility to periodically set its Base Liquidity Resources and to adjust Base Liquidity Resources in response to changing market and business conditions to ensure that OCC maintains sufficient liquidity resources to cover its liquidity risk exposures at all times. The proposed rule change would apply to all Clearing Members equally and any potential change in the Clearing Fund Cash Requirement would continue to be allocated to Clearing Members based on their proportionate share of the overall

Clearing Fund size as determined by Rule 1003(a)(y). OCC does not believe the proposed rule change would affect Clearing Members' access to OCC's services or disadvantage or favor any particular user in relationship to another user.

#### 4. Two-Day Notice Period for Substitutions Involving Excess Clearing Fund Cash

OCC does not believe the proposed introduction of a two-day notice period for any Clearing Member requesting to substitute Government Securities for cash deposits in excess of such Clearing Member's proportionate share of the Clearing Fund Cash Requirement would have any impact, or impose any burden, on competition. The proposed rule change is intended to provide additional certainty around the level of liquidity resources available to OCC at any given time by fixing the amount of cash in the Clearing Fund, and thereby fixing the amount of OCC's Available Liquid Resources, for any given two-day liquidation horizon. The proposed rule change would apply equally to all Clearing Members. OCC notes that Clearing Members would continue to be able to immediately withdraw cash deposits that are above their Clearing Fund Cash Requirement provided that they have equivalent amount of excess Clearing Fund deposits (as provided under Rule 1008). Moreover, OCC notes that it would retain the discretion to waive the two-day notification period if the substitution would not result in any Clearing Member's settlement obligations exceeding the liquidity resources available to satisfy such settlement obligations. OCC does not believe the proposed rule change would affect Clearing Members' access to OCC's services or disadvantage or favor any particular user in relationship to another user.

#### 5. Contingency Funding Plan

OCC proposes to enhance its Contingency Funding Plan by using the output of certain stress test scenarios (i.e., Sufficiency Scenarios) in place of its current process for forecasting reasonably anticipated settlement obligations to determine whether to require additional cash deposits from its Clearing Members. While the use of stress scenarios in the Contingency Funding Plan process could potentially result in a wider or different subset of Clearing Members being subject to Required Cash Deposits than those currently subject to calls under the current Contingency Funding Plan, OCC does not believe the proposed rule change would affect Clearing Members'

<sup>105</sup> See *supra* notes 21 and 22 and associated text.

access to OCC's services or disadvantage or favor any particular user in relationship to another user. The purpose of the proposed change is to allow OCC to more appropriately monitor its liquidity exposures under a variety of foreseeable stress scenarios, including the default of the Clearing Member Group that would generate the largest aggregate payment obligation to OCC in extreme but plausible market conditions, and to call for additional liquid resources in the form of cash deposits from those Clearing Members driving OCC's largest liquidity demands to ensure that OCC continues to maintain compliance with its regulatory obligations under the Exchange Act and Rule 17Ad-22(e)(7) thereunder. OCC therefore believes that any impact on competition or OCC's Clearing Members would be necessary and appropriate in furtherance of the protection of investors and the public interest under the Act.

#### 6. Required Cash Deposits for Clearing Members on Watch Level

OCC proposes to add new Rule 604(g) to provide OCC with authority to require Clearing Members to deposit a specified amount of cash to satisfy its margin requirements as a protective measure if a Clearing Member is determined to present increased credit risk and is subject to enhanced monitoring and surveillance under OCC's watch level reporting process. OCC does not believe the proposed rule change would impose any burden on competition. OCC notes that this rule would apply to all Clearing Members equally and would only be applicable if a Clearing Member was identified as presenting increased risk through OCC's watch level reporting process. OCC does not believe the proposed rule change would affect Clearing Members' access to OCC's services or disadvantage or favor any particular user in relationship to another user. OCC believes that, to the extent there would be any competitive impact, it would not constitute a burden on competition, and would be necessary and appropriate in furtherance of the protection of investors and the public interest under the Act.

#### 7. Enhancements to Rules Concerning the Borrowing of Clearing Fund Assets

OCC does not believe the proposed changes concerning its authority to borrow and use Clearing Fund assets for liquidity risk management purposes would have any impact, or impose any burden, on competition. The proposed rule change is intended to provide further clarity around OCC's existing

authority to borrow Clearing Fund assets, and to replenish its liquidity resources when necessary, and would apply equally to all Clearing Fund contributions. OCC does not believe the proposed rule change would affect Clearing Members' access to OCC's services or disadvantage or favor any particular user in relationship to another user.

#### 8. Requirement for Clearing Members To Maintain Contingency Plans for Settlement

OCC does not believe the proposed rule change to require that every Clearing Member maintain adequate procedures, including but not limited to contingency funding, to ensure that it is able to meet its obligations arising in connection with clearing membership, would have any impact, or impose any burden, on competition. The proposed rule change is intended to reduce liquidity risk at OCC by requiring that Clearing Members have adequate contingency planning designed to effect timely settlement of their obligations with OCC despite a disruption by their primary settlement bank. These arrangements could include maintaining ability to wire funds directly to OCC via Fedwire or by providing instructions to another bank to effect the movement of funds. OCC notes that this rule would apply equally to all Clearing Members. Moreover, OCC does not believe the proposed rule change would affect Clearing Members' access to OCC's services or disadvantage or favor any particular user in relationship to another user.

#### 9. Other Clarifying and Conforming Changes

Finally, OCC proposes to make a number of other non-substantive clarifying, conforming, and organizational changes to the OCC Rules and Risk Policies in connection with the implementation of the proposed change described herein. The proposed changes would not have any impact, or impose any burden, on competition and would not affect Clearing Members' access to OCC's services or disadvantage or favor any particular user in relationship to another user.

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

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

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

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

(A) By order approve or disapprove the proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

### IV. Solicitation of Comments

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

#### *Electronic Comments*

- Use the Commission's internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-OCC-2020-003 on the subject line.

#### *Paper Comments*

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

All submissions should refer to File Number SR-OCC-2020-003. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for

inspection and copying at the principal office of OCC and on OCC's website at <https://www.theocc.com/about/publications/bylaws.jsp>.

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

All submissions should refer to File Number SR–OCC–2020–003 and should be submitted on or before May 15, 2020.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>106</sup>

**J. Matthew DeLesDernier,**  
Assistant Secretary.

[FR Doc. 2020–08692 Filed 4–23–20; 8:45 am]

BILLING CODE 8011–01–P

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–88703]

### Order Granting Limited Exemptive Relief, Pursuant to Section 36 of the Securities Exchange Act of 1934 (“Exchange Act”) and Rule 608(e) of Regulation NMS Under the Exchange Act, Related to Certain Introducing Brokers, From the Requirements of the National Market System Plan Governing the Consolidated Audit Trail

April 20, 2020.

By letter dated February 3, 2020, BOX Exchange LLC; Cboe BYX Exchange, Inc.; Cboe BZX Exchange, Inc.; Cboe EDGA Exchange, Inc.; Cboe EDGX Exchange, Inc.; Cboe C2 Exchange, Inc.; Cboe Exchange, Inc.; Financial Industry Regulatory Authority, Inc. (“FINRA”); Investors Exchange LLC; Long-Term Stock Exchange, Inc.; Miami International Securities Exchange, LLC; MIAX Emerald, LLC; MIAX Pearl, LLC; Nasdaq BX, Inc.; Nasdaq GEMX, LLC; Nasdaq ISE, LLC; Nasdaq MRX, LLC; Nasdaq PHLX LLC; The Nasdaq Stock Market LLC; New York Stock Exchange LLC; NYSE American LLC; NYSE Arca, Inc.; NYSE Chicago, Inc.; and NYSE National, Inc. (collectively, the “Participants” to the National Market System (“NMS”) Plan Governing the Consolidated Audit Trail (“CAT NMS Plan”))<sup>1</sup> requested that the Securities and Exchange Commission

(“Commission” or “SEC”), pursuant to its authority under Section 36 of the Securities Exchange Act of 1934 (“Exchange Act”)<sup>2</sup> and Rule 608(e) of Regulation NMS under the Exchange Act,<sup>3</sup> grant exemptive relief from certain provisions of the CAT NMS Plan related to broker-dealers that do not qualify as Small Industry Members solely because such broker-dealers satisfy Rule 0–10(i)(2) under the Exchange Act<sup>4</sup> in that they introduce transactions on a fully disclosed basis to clearing firms that are not small businesses or small organizations (for purposes of this order, such broker-dealers are referred to as “Introducing Brokers” or “Introducing Industry Members”).<sup>5</sup> Specifically, the Participants request that the Commission provide exemptive relief from requiring Introducing Industry Members to comply with the requirements of the CAT NMS Plan that apply to Industry Members other than Small Industry Members (“Large Industry Members”), provided that the Participants require such Introducing Industry Members to comply with the requirements of the CAT NMS Plan that apply to Small Industry Members.<sup>6</sup> The Participants state that the CAT NMS Plan permits Small Industry Members to begin reporting to the CAT later than Large Industry Members.<sup>7</sup>

Under the CAT NMS Plan, a Small Industry Member is an Industry Member that qualifies as a small broker-dealer as defined in Rule 613 under the Exchange Act.<sup>8</sup> Rule 613 incorporates the definition of small broker-dealer in Rule 0–10(c) under the Exchange Act.<sup>9</sup> Exchange Act Rule 0–10(c) defines a small broker or dealer to mean a broker or dealer that:

(1) Had total capital (net worth plus subordinated liabilities) of less than \$500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to § 240.17a–5(d) or, if not required to file such statements, a broker or

dealer that had total capital (net worth plus subordinated liabilities) of less than \$500,000 on the last business day of the preceding fiscal year (or in the time that it has been in business, if shorter); and

(2) Is not affiliated with any person (other than a natural person) that is not a small business or small organization as defined in this section.

Under Exchange Act Rule 0–10(i),<sup>10</sup> a broker or dealer is affiliated with another person for purposes of Exchange Act Rule 0–10(c) if:

(1) Such broker or dealer controls, is controlled by, or is under common control with such other person; a person shall be deemed to control another person if that person has the right to vote 25 percent or more of the voting securities of such other person or is entitled to receive 25 percent or more of the net profits of such other person or is otherwise able to direct or cause the direction of the management or policies of such other person; or

(2) Such broker or dealer introduces transactions in securities, other than registered investment company securities or interests or participations in insurance company separate accounts, to such other person, or introduces accounts of customers or other brokers or dealers, other than accounts that hold only registered investment company securities or interests or participations in insurance company separate accounts, to such other person that carries such accounts on a fully disclosed basis.

In the CAT NMS Plan Approval Order, the Commission stated that the CAT NMS Plan provides a capital level-based definition of Small Industry Members for purposes of the CAT NMS Plan implementation schedule.<sup>11</sup> The Commission further stated that the definition is derived from Exchange Act Rule 0–10, which defines small entities under the Exchange Act for purposes of the Regulatory Flexibility Act, and reflects an “existing regulatory standard that is an indication of small entities for which regulators should be sensitive when imposing regulatory burdens.”<sup>12</sup> The Commission stated that the definition of Small Industry Member is a reasonable means to identify market participants for which it would be appropriate to provide, and that would benefit from, an additional year to prepare for CAT reporting due to their relatively limited resources.<sup>13</sup>

Under Exchange Act Rule 0–10(i)(2), an Introducing Broker would not be a small broker-dealer as defined in Exchange Act Rule 0–10(c) if the

<sup>2</sup> 15 U.S.C. 78mm(a)(1).

<sup>3</sup> 17 CFR 242.608(e).

<sup>4</sup> 17 CFR 240.0–10(i)(2).

<sup>5</sup> See letter from Mike Simon, CAT NMS Plan Operating Committee Chair, to Vanessa Countryman, Secretary, U.S. Securities and Exchange Commission, dated February 3, 2020 (“Exemption Request”). Unless otherwise noted, capitalized terms are used as defined in Rule 613 of Regulation NMS, in the CAT NMS Plan, or in this letter. “Industry Member” means “a member of a national securities exchange or a member of a national securities association.” “Small Industry Member” means “an Industry Member that qualifies as a small broker-dealer as defined in SEC Rule 613.” See CAT NMS Plan at Section 1.1.

<sup>6</sup> See Exemption Request.

<sup>7</sup> See *id.* at 2.

<sup>8</sup> 17 CFR 242.613. See CAT NMS Plan at Section 1.1.

<sup>9</sup> 17 CFR 240.0–10(c).

<sup>10</sup> 17 CFR 240.0–10(i).

<sup>11</sup> See CAT NMS Plan Approval Order, 81 FR at 84771.

<sup>12</sup> See *id.* (citing Securities Exchange Act Release No. 67457 (July 18, 2012), 77 FR 45722, 45804 (August 1, 2012) (“Rule 613 Adopting Release”).

<sup>13</sup> See CAT NMS Plan Approval Order, 81 FR at 84771.

<sup>106</sup> 17 CFR 200.30–3(a)(12).

<sup>1</sup> The Commission approved the CAT NMS Plan, as modified, on November 15, 2016. See Securities Exchange Act Release No. 79318 (November 15, 2016), 81 FR 84696 (November 23, 2016) (“CAT NMS Plan Approval Order”).