



June 9, 2020

VIA ELECTRONIC MAIL

Christopher J. Kirkpatrick
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: Rule Filing SR-OCC-2020-003 Rule Certification

Dear Secretary Kirkpatrick:

Pursuant to Section 5c(c)(1) of the Commodity Exchange Act, as amended (“Act”), and Commodity Futures Trading Commission (“CFTC”) Regulation 40.6, enclosed is a copy of the above-referenced rule filing submitted by The Options Clearing Corporation (“OCC”). The date of implementation of the rule is at least 10 business days following receipt of the rule filing by the CFTC or the date the proposed rule is approved by the Securities and Exchange Commission (“SEC”) or otherwise becomes effective under the Securities Exchange Act of 1934 (the “Exchange Act”). This rule filing has been submitted to the SEC under the Exchange Act.

OCC has requested confidential treatment for Exhibits 3 and 5B – 5H to SR-OCC-2020-003 (contained in pages 156-206 and 217-349 of SR-OCC-2020-003).

In conformity with the requirements of Regulation 40.6(a)(7), OCC states the following:

Explanation and Analysis

The proposed rule change by OCC concerns enhancements to OCC’s overall framework for managing liquidity risk. Specifically, the proposed changes would:

- (1) establish a new Liquidity Risk Management Framework (“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 Clearing Fund and stress testing methodology (“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 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.¹

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.² OCC's primary

¹ OCC's By-Laws and Rules can be found on OCC's public website: <http://optionsclearing.com/about/publications/bylaws.jsp>.

² 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>.

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"³ 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 financial 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:

³ OCC's committed liquidity facilities may be comprised of both bank and non-bank committed facilities.

- (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 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.⁴ For Clearing Members participating in external cross-margin arrangements, these potential liquidity obligations are evaluated in accordance with the provisions set forth in 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 defaulted 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. 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.

Liquidity Resources

The proposed LRMF describes 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))⁵ 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

⁴ 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).

⁵ 17 CFR 240.17Ad-22(a)(14).

and convertible into cash through prearranged funding arrangements⁶ and required Clearing Fund cash on deposit.⁷ 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 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.⁸

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

⁶ 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.

⁷ 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.

⁸ 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), 82 FR 2843 (January 19, 2018) (SR-OCC-2017-808).

minimum required amount.⁹ 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 accordion¹⁰ 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

⁹ These excess amounts are only included in Available Liquidity Resources by the amount the required Clearing Fund size exceeds the minimum Clearing Fund size as determined by OCC Rule 1001(b). Cash deposits in excess of a Clearing Member's total Clearing Fund requirement would not be included.

¹⁰ An accordion is an uncommitted expansion of the credit facility generally on the same terms as the credit facility.

testing would rely on the stressed scenarios and prices generated under OCC's current stress testing and Clearing Fund methodology.¹¹ 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").¹² 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),¹³ 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.¹⁴ This analysis may also include the results of a comprehensive review of any parameters and assumptions used by OCC's stress testing system, the output of which is used to project potential liquidity demands under

¹¹ See *infra* notes 19 and 20 and associated text.

¹² 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.

¹³ 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.

¹⁴ 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.

stressed market conditions.¹⁵ 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) promptly 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.¹⁶ 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.

¹⁵ These parameters and assumptions are routinely reviewed by STWG, on at least a monthly basis.

¹⁶ 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).

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")¹⁷ 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 OCC's 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.¹⁸ 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 the 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) any other relevant aspects of OCC's liquidity risk management.

On at least an annual basis, FRM would assesses the adequacy of OCC's stress testing methodology, the output of which is used to evaluate OCC's liquidity resource risks. Proposed

¹⁷ If escalation to the CLRWG is not practical, issues would be escalated to OCC's Management Committee.

¹⁸ 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.

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 stress testing and Clearing Fund methodology,¹⁹ 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%

¹⁹ 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).

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 credit 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");²⁰ 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

²⁰ 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.

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 cash flows 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"²¹ and closing long and short positions in the same series between account types as "internalization."²² 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.²³ 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

²¹ 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.

²² 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.

²³ Id.

account type, potentially subject to a lien²⁴ 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"²⁵ or a "restricted lien"²⁶ 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).²⁷ 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;²⁸ (5) OCC accounts for liquidity demands as required by relevant cross-margin agreements; (6) that auction bids are represented by stressed prices at the

²⁴ 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.

²⁵ "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.

²⁶ 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.

²⁷ See Article VI, Section 3(e) of OCC's By-Laws.

²⁸ 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.

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.²⁹

Under the proposed approach, OCC would assume that positions³⁰ 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,³¹ 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.³² 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.

²⁹ 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 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.

³⁰ 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.

³¹ The term “moneyness” refers to the relationship between the current market price of the underlying interest and the exercise price.

³² See supra note 12.

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 adequacy and sufficiency 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 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.³³

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

³³ 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.

and loss calculations in order to account for SWWR in the stress testing system.³⁴ 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

³⁴ 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 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.³⁵ 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.³⁶ However, revised Rule 1002(a) would require that the Clearing Fund Cash Requirement never be 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 OCC's CFM Policy and will also be described in the proposed LRMF.³⁷ 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 Committees 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

³⁵ OCC also proposes non-substantive revisions to its Rules and OCC Risk Policies to redefine this requirement as the "Clearing Fund Cash Requirement."

³⁶ 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. This analysis has been provided in confidential Exhibit 3 to File No. SR-OCC-2020-003. OCC would inform Clearing Members of any change in the Clearing Fund Cash Requirement through Information Memoranda and Clearing Fund sizing reports.

³⁷ 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.

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.³⁸ 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

³⁸ OCC notes that the Clearing Fund Cash Requirement would initially be set at \$3.5 billion.

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 Liquidity 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 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 call³⁹ in situations in which a Clearing Member's reasonably anticipated settlement obligations to OCC

³⁹ 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.

exceeded the liquid financial resources available to satisfy such obligations.⁴⁰ 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.⁴¹ 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.⁴²

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.⁴³

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

⁴⁰ 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).

⁴¹ 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>.

⁴² 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.

⁴³ See *supra* note 3.

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.⁴⁴ 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

⁴⁴ 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 re-calculated daily and remain in place until the projected demand no longer exceeds 90% of Available Liquidity Resources.

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 recommend 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 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 LRMF, 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 LRMF, 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.⁴⁵ Additionally, OCC endeavors to have an uncommitted accordion⁴⁶ 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.

⁴⁵ See supra notes 35 - 38 and associated text.

⁴⁶ An accordion is an uncommitted expansion of a credit facility generally on the same terms as a credit facility.

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.⁴⁷ 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

⁴⁷ OCC's watch level reporting process is outlined in its CCRM Policy. See supra note 16.

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 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).⁴⁸

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

⁴⁸ See supra note 4.

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'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.⁴⁹

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

⁴⁹ 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.

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 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)).⁵⁰

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

⁵⁰ 17 CFR 240.17Ad-22(a)(14).

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.⁵¹ 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.

OCC reviewed the derivatives clearing organization ("DCO") core principles as set forth in the Act ("Core Principles"). During this review, OCC identified the following Core Principles as potentially being impacted:

Financial resources. OCC believes that implementing the proposed rule change would be consistent with the Core Principle B,⁵² which requires, in part, that each DCO possess financial resources that, at a minimum, exceed the total amount that would enable it to meet its financial obligations to its members and participants notwithstanding a default by the member or participant

⁵¹ 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.

⁵² 7 U.S.C. 7a-1(c)(2)(B).

creating the largest financial exposure for that organization in extreme but plausible market conditions. CFTC Regulation 39.11(e)⁵³ further requires, in part, that a DCO shall effectively measure, monitor, and manage its liquidity risks, maintaining sufficient liquid resources such that it can, at a minimum, fulfill its cash obligations when due and that financial resources allocated by the DCO to meet the requirements of CFTC Regulation 39.11(a)(1)⁵⁴ shall be sufficiently liquid to enable the DCO to fulfill its obligations as a central counterparty during a one-day settlement cycle.

OCC proposes to adopt a new LRMF to 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 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 management of liquidity risk.

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. As described above, 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 its Base and Available Liquidity Resources; (2) assess OCC's liquidity resources against OCC's liquidity risk tolerance of a 1-in-50 year hypothetical market event; (3) measure the sufficiency of OCC's liquidity resources to determine if additional risk mitigation is needed when stress exposures breach specified thresholds of certain historical market events; 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 changes is designed to enable OCC to maintain 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.⁵⁵

⁵³ 17 CFR 39.11(e).

⁵⁴ CFTC Regulation 39.11(a)(1) requires, in part, that a DCO maintain sufficient financial resources to cover its exposures with a high degree of confidence and possess financial resources that exceed the total amount that would enable it to meet its financial obligations to its clearing members notwithstanding a default by the clearing member creating the largest financial exposure in extreme but plausible market conditions. 17 CFR 39.11(a)(1).

⁵⁵ OCC notes that its Base and Available Liquidity Resources would be comprise of "qualifying liquid resources" as defined in Exchange Act Rule 17Ad-22(a)(14), which is generally aligned with

The proposed changes would enhance OCC's Contingency Funding Plan to include the use of certain 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. OCC also proposes changes to its rules 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 potential liquidity risk exposures so that it can continue to meet its settlement obligations in a timely manner. The proposed changes would allow OCC to adjust its Base Liquidity Resources in the normal course to account for potential stress test results that estimate liquidity demands exceeding OCC's Cover 1 liquidity resources and would provide additional flexibility for temporarily increasing the Clearing Fund Cash Requirement up to an amount that includes the size of the Clearing Fund to address unanticipated or unforeseeable liquidity shortfalls that otherwise would not be covered by OCC's liquid resources. In addition, 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 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.

OCC would also 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. In addition, OCC proposes several changes to its rules to clarify its authority to use Clearing Fund assets to address potential liquidity needs and provide additional clarity and transparency to OCC's Clearing Members regarding OCC's use of Clearing Fund cash as a liquidity resource. OCC also 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.

For the foregoing reasons, OCC believes that implementing the proposed rule change would be consistent with the Core Principle B and the CFTC Regulations thereunder.

"qualifying liquidity resources" as defined in CFTC Regulation 39.33(c)(3) and is the heightened standard applicable to Subpart C DCOs.

Risk management. OCC believes that implementing the proposed rule change would be consistent with the Core Principle D,⁵⁶ which requires, in general, that each DCO ensure that it possesses the ability to manage the risks associated with discharging the responsibilities of the DCO through the use of appropriate tools and procedures. CFTC Regulation 39.13(h)(3)(ii)⁵⁷ further requires, in part, that each DCO conduct stress tests on at least a weekly basis with respect to each clearing member account, by house origin and by each customer origin, under extreme but plausible market conditions. As described above, 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 designed to assess the adequacy and sufficiency of OCC's liquidity resources 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. Accordingly, OCC believes the proposal is consistent with the Core Principle D.

Participant and product eligibility. OCC believes that the proposed rule change would also be consistent with the Core Principle C,⁵⁸ which requires, in part, that each DCO establish appropriate admission and continuing eligibility standards (including sufficient financial resources and operational capacity to meet obligations arising from participation in the DCO) for members of, and participants in, the DCO and that participation and membership requirements be objective, publicly disclosed, and permit fair and open access. OCC proposes to amend Rule 301(d) to require that each 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 the proposed rule is objective and risk-based in that it would apply to all Clearing Members and is intended to reduce the likelihood that a Clearing Member would be unable to satisfy their settlement obligations to OCC. The proposed requirement would also be publicly disclosed in OCC's Rules. OCC therefore believes that the proposed rule change would be consistent with the Core Principle C.

⁵⁶ 7 U.S.C. 7a-1(c)(2)(D).

⁵⁷ 17 CFR 39.13(h)(3)(ii).

⁵⁸ 7 U.S.C. 7a-1(c)(2)(C).

Opposing Views

No opposing views were expressed related to the rule amendments.

Notice of Pending Rule Certification

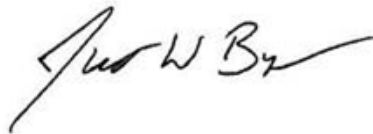
OCC hereby certifies that notice of this rule filing has been given to Clearing Members of OCC in compliance with Regulation 40.6(a)(2) by posting a copy of the submission on OCC's website concurrently with the filing of this submission.

Certification

OCC hereby certifies that the rule set forth at Item 1 of the enclosed filing complies with the Act and the CFTC's regulations thereunder.

Should you have any questions regarding this matter, please do not hesitate to contact me.

Sincerely,

A handwritten signature in black ink, appearing to read "Justin W. Byrne". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Justin W. Byrne
Vice President, Regulatory Filings

Enclosure

Required fields are shown with yellow backgrounds and asterisks.

Page 1 of * 349	SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549 Form 19b-4	File No.* SR - 2020 - * 003	Amendment No. (req. for Amendments *)
-----------------	--	-----------------------------	---------------------------------------

Filing by Options Clearing Corporation
Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial *	Amendment *	Withdrawal	Section 19(b)(2) *	Section 19(b)(3)(A) *	Section 19(b)(3)(B) *
<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Pilot <input type="checkbox"/> Extension of Time Period for Commission Action * <input type="checkbox"/> Date Expires * <input type="text"/>			Rule		
			<input type="checkbox"/> 19b-4(f)(1)	<input type="checkbox"/> 19b-4(f)(4)	
			<input type="checkbox"/> 19b-4(f)(2)	<input type="checkbox"/> 19b-4(f)(5)	
			<input type="checkbox"/> 19b-4(f)(3)	<input type="checkbox"/> 19b-4(f)(6)	

Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010 Section 806(e)(1) * <input type="checkbox"/> Section 806(e)(2) * <input type="checkbox"/>	Security-Based Swap Submission pursuant to the Securities Exchange Act of 1934 Section 3C(b)(2) * <input type="checkbox"/>
--	---

Exhibit 2 Sent As Paper Document <input type="checkbox"/>	Exhibit 3 Sent As Paper Document <input type="checkbox"/>
---	---

Description

Provide a brief description of the action (limit 250 characters, required when Initial is checked *).

Proposed Rule Change Related to Proposed Changes to The Options Clearing Corporation's Framework for Liquidity Risk Management

Contact Information

Provide the name, telephone number, and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the action.

First Name * Justin	Last Name * Byrne
Title * Vice President, Regulatory Filings	
E-mail * jbyrne@theocc.com	
Telephone * (202) 971-7238	Fax (312) 322-6280

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

(Title *)

Date 04/06/2020	Vice President, Regulatory Filings
By Justin W. Byrne	
(Name *)	

Justin Byrne, jbyrne@theocc.com

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFS website.

Form 19b-4 Information *

Add Remove View

The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change *

Add Remove View

The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 1A- Notice of Proposed Rule Change, Security-Based Swap Submission, or Advance Notice by Clearing Agencies *

Add Remove View

The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change, security-based swap submission, or advance notice being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications

Add Remove View

Exhibit Sent As Paper Document

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

Exhibit 3 - Form, Report, or Questionnaire

Add Remove View

Exhibit Sent As Paper Document

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

Exhibit 4 - Marked Copies

Add Remove View

The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

Add Remove View

The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

Partial Amendment

Add Remove View

If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 19b-4

Proposed Rule Change
by

THE OPTIONS CLEARING CORPORATION

Pursuant to Rule 19b-4 under the
Securities Exchange Act of 1934

Item 1. Text of the Proposed Rule Change

Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act” or “Act”),¹ and Rule 19b-4 thereunder,² The Options Clearing Corporation (“OCC” or the “Corporation”) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change to 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 actual liquidity risk exceeds certain defined thresholds;
- (6) amend Chapter VI of the Rules to allow OCC to require cash margin as a protective

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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.³

Item 2. Procedures of the Self-Regulatory Organization

The proposed rule change was approved for filing with the Commission by the Risk Committee of OCC's Board of Directors on January 14, 2019, pursuant to authority delegated by the Board of Directors on December 12, 2018. Additional modifications to the proposal were approved by the Risk Committee and the Board of Directors on December 11, 2019.

Questions should be addressed to Justin W. Byrne, Vice President, Regulatory Filings, at (202) 971-7238.

Item 3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

A. 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.⁴ 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

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

⁴ 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>.

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”⁵ 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

⁵ OCC’s committed liquidity facilities may be comprised of both bank and non-bank committed facilities.

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;
- (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.⁶ 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

⁶ 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).

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.

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))⁷ 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

⁷ 17 CFR 240.17Ad-22(a)(14).

cash through prearranged funding arrangements⁸ and required Clearing Fund cash on deposit.⁹ 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 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

⁸ 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.

⁹ 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.

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.¹⁰

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.¹¹ 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.

¹⁰ 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), 82 FR 2843 (January 19, 2018) (SR-OCC-2017-808).

¹¹ 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.

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 accordion¹² 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

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

current stress testing and Clearing Fund methodology.¹³ 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").¹⁴ 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),¹⁵ FRM would present to the Board and Risk Committee an analysis summarizing the projected liquidity demands OCC may

¹³ See infra notes 22 and 22 and associated text.

¹⁴ 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.

¹⁵ 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.

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.¹⁶ This analysis may also include the results of a comprehensive review of 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.¹⁷ 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,

¹⁶ 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.

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

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.¹⁸ 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

¹⁸ 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).

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")¹⁹ 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.²⁰ 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

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

²⁰ 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.

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 assesses 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 stress testing

and Clearing Fund methodology,²¹ 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.,

²¹ 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).

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”);²² 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

²² 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.

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”²³ and closing long and short positions in the same series between account types as “internalization.”²⁴ 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

²³ 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.

²⁴ 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.

liquidating value associated with each account type.²⁵ 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 lien²⁶ 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"²⁷ or a "restricted lien"²⁸ 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).²⁹ 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

²⁵ Id.

²⁶ 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.

²⁷ "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.

²⁸ 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.

²⁹ See Article VI, Section 3(e) of OCC's By-Laws.

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;³⁰ (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

³⁰ 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.

liquidity demands.³¹

Under the proposed approach, OCC would assume that positions³² 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,³³ 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

³¹ 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 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.

³² 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.

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

Agreement by and between OCC and NSCC.³⁴ 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 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%

³⁴ See supra note 14.

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.³⁵

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

³⁵ 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.

the stress testing system.³⁶ 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

³⁶ 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).

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.³⁷ 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.³⁸ However, revised Rule 1002(a) would require that the Clearing Fund Cash Requirement never be set at an amount lower than \$3 billion.

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

³⁸ 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. This analysis has been provided in confidential Exhibit 3 to File No. SR-OCC-2020-003. OCC would inform Clearing Members of any change in the Clearing Fund Cash Requirement through Information Memoranda and Clearing Fund sizing reports.

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 OCC's CFM Policy and will also be described in the proposed LRMF.³⁹ 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 Committees 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

³⁹ 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.

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.⁴⁰ 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

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

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 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 call⁴¹ in situations in which a Clearing Member's reasonably

⁴¹ 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.

anticipated settlement obligations to OCC exceeded the liquid financial resources available to satisfy such obligations.⁴² 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.⁴³ 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.⁴⁴

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

⁴² 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).

⁴³ 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>.

⁴⁴ 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.

available to satisfy such obligations, OCC compares the forecasted liquidity amount against the drawable amount of its committed liquidity facilities.⁴⁵

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.

⁴⁵ See supra note 5.

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.⁴⁶ 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

⁴⁶ 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 re-calculated daily and remain in place until the projected demand no longer exceeds 90% of Available Liquidity Resources.

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 recommend 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 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.⁴⁷ Additionally, OCC endeavors to have an uncommitted accordion⁴⁸ 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

⁴⁷ See supra notes 37 - 40 and associated text.

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

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.⁴⁹ 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

⁴⁹ OCC's watch level reporting process is outlined in its CCRM Policy. See supra note 18.

operational disruption of a bank or securities or 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).⁵⁰

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.

⁵⁰ See supra note **Error! Bookmark not defined.**

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.⁵¹

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.

⁵¹ 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.

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 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)).⁵²

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

⁵² 17 CFR 240.17Ad-22(a)(14).

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.⁵³ 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.

B. 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,⁵⁴ 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

⁵³ 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.

⁵⁴ 15 U.S.C. 78q-1(b)(3)(F).

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)⁵⁵ 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

⁵⁵ 17 CFR 240.17Ad-22(e)(7).

proposed LRMF is consistent with the requirements of Section 17A(b)(3)(F) of the Act.⁵⁶

Rule 17Ad-22(e)(7)⁵⁷ 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 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).⁵⁸

Rules 17Ad-22(e)(7)(i) and (ii)⁵⁹ require a CCA to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain sufficient liquid

⁵⁶ 15 U.S.C. 78q-1(b)(3)(F).

⁵⁷ 17 CFR 240.17Ad-22(e)(7).

⁵⁸ Id.

⁵⁹ 17 CFR 240.17Ad-22(e)(7)(i) and (ii).

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).⁶⁰

Rule 17Ad-22(e)(7)(iii)⁶¹ 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

⁶⁰ Id.

⁶¹ 17 CFR 240.17Ad-22(e)(7)(iii).

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)⁶² 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).⁶³

Rule 17Ad-22(e)(7)(vi)(A)⁶⁴ 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

⁶² 17 CFR 240.17Ad-22(e)(7)(iv) and (v).

⁶³ Id.

⁶⁴ 17 CFR 240.17Ad-22(e)(7)(vi)(A).

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.⁶⁵ OCC therefore believes that the proposed LRMF is reasonably designed to comply with the requirements of Rule 17Ad-22(e)(7)(vi)(A).⁶⁶

Rules 17Ad-22(e)(7)(vi)(B) – (D)⁶⁷ 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

⁶⁵ 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.

⁶⁶ 17 CFR 240.17Ad-22(e)(7)(vi)(A).

⁶⁷ 17 CFR 240.17Ad-22(e)(7)(vi)(B) – (D).

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 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).⁶⁸

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

⁶⁸

Id.

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.⁶⁹

Rule 17Ad-22(e)(7)(i)⁷⁰ requires a CCA to establish, implement, maintain and enforce

⁶⁹ 15 U.S.C. 78q-1(b)(3)(F).

⁷⁰ 17 CFR 240.17Ad-22(e)(7)(i).

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)⁷¹ 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

⁷¹ 17 CFR 240.17Ad-22(e)(7)(vi)(A).

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.⁷² 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).⁷³

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 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

⁷² 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.

⁷³ 17 CFR 240.17Ad-22(e)(7)(i) and (e)(vi)(A)

a two-year look back period⁷⁴ 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.⁷⁵

Additionally, Rule 17Ad-22(e)(7)(i)⁷⁶ 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

⁷⁴ See supra note 38.

⁷⁵ 15 U.S.C. 78q-1(b)(3)(F).

⁷⁶ 17 CFR 240.17Ad-22(e)(7)(i).

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).⁷⁷

Further, Rule 17Ad-22(e)(7)(viii)⁷⁸ requires that a CCA address foreseeable liquidity shortfalls that would not be covered by its liquid resources and Rule 17Ad-22(e)(7)(ix)⁷⁹ 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).⁸⁰

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

⁷⁷ Id.

⁷⁸ 17 CFR 240.17Ad-22(e)(7)(viii).

⁷⁹ 17 CFR 240.17Ad-22(e)(7)(ix).

⁸⁰ 17 CFR 240.17Ad-22(e)(7)(viii) and (ix).

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.⁸¹ 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.⁸²

Rules 17Ad-22(e)(7)(i) and (ii)⁸³ 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

⁸¹ 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).

⁸² 15 U.S.C. 78q-1(b)(3)(F).

⁸³ 17 CFR 240.17Ad-22(e)(7)(i) and (ii).

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).⁸⁴

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 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

⁸⁴

Id.

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.⁸⁵

Rule 17Ad-22(e)(7)(vi)(A)⁸⁶ 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)⁸⁷ 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

⁸⁵ 15 U.S.C. 78q-1(b)(3)(F).

⁸⁶ 17 CFR 240.17Ad-22(e)(7)(vi)(A).

⁸⁷ 17 CFR 240.17Ad-22(e)(7)(viii).

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).⁸⁸

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

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

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.⁸⁹

Additionally, Rule 17Ad-22(e)(7)⁹⁰ 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)⁹¹ 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

⁸⁹ 15 U.S.C. 78q-1(b)(3)(F).

⁹⁰ 17 CFR 240.17Ad-22(e)(7).

⁹¹ Id.

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.⁹² Second, OCC proposes to amend Rule 1006(f) to permit OCC to reject a Clearing 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 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

⁹² 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.

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.⁹³

Rule 17Ad-22(e)(7)⁹⁴ 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)⁹⁵ 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).⁹⁶

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

⁹³ 15 U.S.C. 78q-1(b)(3)(F).

⁹⁴ 17 CFR 240.17Ad-22(e)(7).

⁹⁵ 17 CFR 240.17Ad-22(e)(7)(ix).

⁹⁶ 17 CFR 240.17Ad-22(e)(7) and (e)(7)(ix).

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 assure the safeguarding 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.⁹⁷

Rule 17Ad-22(e)(18)⁹⁸ 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).⁹⁹

9. Other Clarifying and Conforming Changes

OCC proposes to make a number of other clarifying, conforming, and organizational

⁹⁷ 15 U.S.C. 78q-1(b)(3)(F).

⁹⁸ 17 CFR 240.17Ad-22(e)(18).

⁹⁹ Id.

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 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. As a result, OCC believes the proposed changes are consistent with the requirements of Section 17A(b)(3)(F) of the Act¹⁰⁰ and Rule 17Ad-22(e)(7) thereunder.¹⁰¹

In addition, Rules 17Ad-22(e)(2)(i) and (v)¹⁰² 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).¹⁰³

Item 4. Self-Regulatory Organization's Statement on Burden on Competition

¹⁰⁰ 15 U.S.C. 78q-1(b)(3)(F).

¹⁰¹ 17 CFR 240.17Ad-22(e)(7).

¹⁰² 17 CFR 240.17Ad-22(e)(2)(i) and (v).

¹⁰³ Id.

Section 17A(b)(3)(I) of the Act¹⁰⁴ 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 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 of 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

¹⁰⁴ 15 U.S.C. 78q-1(b)(3)(I).

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.¹⁰⁵ 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

¹⁰⁵ See supra notes 22 and 22 and associated text.

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' 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.

Item 5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

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

Item 6. Extension of Time Period for Commission Action

Not applicable.

Item 7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2) or Section 19(b)(7)(D)

Not applicable.

Item 8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

Item 9. Security-Based Swap Submissions Filed Pursuant to Section 3C of the Act

Not applicable.

Item 10. Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

Not applicable.

Item 11. Exhibits

Exhibit 1A. Completed Notice of Proposed Rule Change for publication in the Federal Register.

Exhibit 3. Confidential Data and Analysis

Exhibit 5A. OCC Rules.

Exhibit 5B. Liquidity Risk Management Framework.

Exhibit 5C. Stress Testing and Clearing Fund Methodology Description.

Exhibit 5D. Risk Management Framework Policy.

Exhibit 5E. Clearing Fund Methodology Policy.

Exhibit 5F. Collateral Risk Management Policy

Exhibit 5G. Counterparty Credit Risk Management Policy.

Exhibit 5H. Default Management Policy.

Exhibit 3 and Exhibits 5B-5H have been omitted and filed separately with the Commission. Confidential treatment of Exhibit 3 and Exhibits 5B-5H is requested pursuant to SEC Rule 24b-2 (17 CFR 240.24b-2).

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, The Options Clearing Corporation has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

THE OPTIONS CLEARING CORPORATION

By:

Justin W. Byrne
Vice President, Regulatory Filings

EXHIBIT 1A

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-[_____]; File No. SR-OCC-2020-003)

April __, 2020

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

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act" or "Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on April 6, 2020, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared 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

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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 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.³

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.

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

(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.⁴ 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)

⁴ 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>.

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”⁵ 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

⁵ OCC’s committed liquidity facilities may be comprised of both bank and non-bank committed facilities.

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;

(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.⁶ 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

⁶ 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).

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.

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))⁷ 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

⁷ 17 CFR 240.17Ad-22(a)(14).

arrangements⁸ and required Clearing Fund cash on deposit.⁹ 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 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").

⁸ 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.

⁹ 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.

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.¹⁰

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.¹¹ 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

¹⁰ 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).

¹¹ 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.

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 accordion¹² features embedded in any syndicated credit facility).

Stress Testing and Liquidity Resource Sizing

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

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.¹³ 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").¹⁴ 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

¹³ See infra notes 22 and 22 and associated text.

¹⁴ 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.

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),¹⁵ 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.¹⁶ This analysis may also include the results of a comprehensive review of 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.¹⁷ In addition, the analysis may include the current composition of OCC's various liquidity resources and recommended changes, if applicable.

¹⁵ 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.

¹⁶ 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.

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

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.¹⁸ 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

¹⁸ 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).

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")¹⁹ 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).

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

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.²⁰ 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

²⁰ 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.

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

Current Stress Testing Approach for Clearing Fund

²¹ 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).

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");²² and (4) monitor and assess the size of OCC's pre-funded financial resource against a wide range of stress scenarios that may include

²² 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.

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”²³ and closing long and short positions in the same series between account types as “internalization.”²⁴ 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

²³ 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.

²⁴ 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.

the liquidating value associated with each account type.²⁵ 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 lien²⁶ 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"²⁷ or a "restricted lien"²⁸ 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).²⁹ 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

²⁵ Id.

²⁶ 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.

²⁷ "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.

²⁸ 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.

²⁹ See Article VI, Section 3(e) of OCC's By-Laws.

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;³⁰ (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

³⁰ 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.

Wrong Way Risk (“SWWR”) positions are included in the appropriate calculations; and (10) early exercise is not assumed in estimating liquidity demands.³¹

Under the proposed approach, OCC would assume that positions³² 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,³³ 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.

³¹ 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 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.

³² 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.

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

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.³⁴ 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 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)

³⁴ See supra note 14.

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.³⁵

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

³⁵ 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.

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.³⁶ 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

³⁶ 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).

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.³⁷ 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

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

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.³⁸ However, revised Rule 1002(a) would require that the Clearing Fund Cash Requirement never be 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 OCC's CFM Policy and will also be described in the proposed LRMF.³⁹ 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

³⁸ 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.

³⁹ 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.

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 Committees 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.⁴⁰ 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

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

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 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 call⁴¹ in situations in which a Clearing Member's reasonably anticipated settlement obligations to OCC exceeded the liquid financial resources available to satisfy such obligations.⁴² 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

⁴¹ 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.

⁴² 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).

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.⁴³ 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.⁴⁴

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.⁴⁵

Proposed Changes

⁴³ 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>.

⁴⁴ 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.

⁴⁵ See supra note 5.

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.⁴⁶ 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

⁴⁶ 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 re-calculated daily and remain in place until the projected demand no longer exceeds 90% of Available Liquidity Resources.

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 recommend 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 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.⁴⁷

Additionally, OCC endeavors to have an uncommitted accordion⁴⁸ 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

⁴⁷ See supra notes 37 - 40 and associated text.

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

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.⁴⁹ 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

⁴⁹ OCC's watch level reporting process is outlined in its CCRM Policy. See supra note 18.

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 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).⁵⁰

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

⁵⁰ See supra note **Error! Bookmark not defined.**

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.⁵¹

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

⁵¹ 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.

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 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)).⁵²

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.

⁵² 17 CFR 240.17Ad-22(a)(14).

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.⁵³ 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,⁵⁴ which requires, among other things, that the rules of a clearing

⁵³ 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.

⁵⁴ 15 U.S.C. 78q-1(b)(3)(F).

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)⁵⁵ 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,

⁵⁵ 17 CFR 240.17Ad-22(e)(7).

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.⁵⁶

Rule 17Ad-22(e)(7)⁵⁷ 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 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;

⁵⁶ 15 U.S.C. 78q-1(b)(3)(F).

⁵⁷ 17 CFR 240.17Ad-22(e)(7).

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).⁵⁸

Rules 17Ad-22(e)(7)(i) and (ii)⁵⁹ 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

⁵⁸ Id.

⁵⁹ 17 CFR 240.17Ad-22(e)(7)(i) and (ii).

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).⁶⁰

Rule 17Ad-22(e)(7)(iii)⁶¹ 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)⁶² 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

⁶⁰ Id.

⁶¹ 17 CFR 240.17Ad-22(e)(7)(iii).

⁶² 17 CFR 240.17Ad-22(e)(7)(iv) and (v).

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).⁶³

Rule 17Ad-22(e)(7)(vi)(A)⁶⁴ 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.⁶⁵ OCC therefore believes that the proposed LRMF is reasonably designed to comply with the requirements of Rule 17Ad-22(e)(7)(vi)(A).⁶⁶

⁶³ Id.

⁶⁴ 17 CFR 240.17Ad-22(e)(7)(vi)(A).

⁶⁵ 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.

⁶⁶ 17 CFR 240.17Ad-22(e)(7)(vi)(A).

Rules 17Ad-22(e)(7)(vi)(B) – (D)⁶⁷ 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 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

⁶⁷ 17 CFR 240.17Ad-22(e)(7)(vi)(B) – (D).

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).⁶⁸

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

⁶⁸

Id.

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.⁶⁹

Rule 17Ad-22(e)(7)(i)⁷⁰ 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)⁷¹ 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

⁶⁹ 15 U.S.C. 78q-1(b)(3)(F).

⁷⁰ 17 CFR 240.17Ad-22(e)(7)(i).

⁷¹ 17 CFR 240.17Ad-22(e)(7)(vi)(A).

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.⁷² 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).⁷³

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 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 period⁷⁴ 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

⁷² 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.

⁷³ 17 CFR 240.17Ad-22(e)(7)(i) and (e)(vi)(A)

⁷⁴ See supra note 38.

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.⁷⁵

Additionally, Rule 17Ad-22(e)(7)(i)⁷⁶ 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).⁷⁷

⁷⁵ 15 U.S.C. 78q-1(b)(3)(F).

⁷⁶ 17 CFR 240.17Ad-22(e)(7)(i).

⁷⁷ Id.

Further, Rule 17Ad-22(e)(7)(viii)⁷⁸ requires that a CCA address foreseeable liquidity shortfalls that would not be covered by its liquid resources and Rule 17Ad-22(e)(7)(ix)⁷⁹ 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).⁸⁰

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

⁷⁸ 17 CFR 240.17Ad-22(e)(7)(viii).

⁷⁹ 17 CFR 240.17Ad-22(e)(7)(ix).

⁸⁰ 17 CFR 240.17Ad-22(e)(7)(viii) and (ix).

any given two-day liquidation horizon.⁸¹ 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.⁸²

Rules 17Ad-22(e)(7)(i) and (ii)⁸³ 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

⁸¹ 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).

⁸² 15 U.S.C. 78q-1(b)(3)(F).

⁸³ 17 CFR 240.17Ad-22(e)(7)(i) and (ii).

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).⁸⁴

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 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

84

Id.

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.⁸⁵

Rule 17Ad-22(e)(7)(vi)(A)⁸⁶ 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)⁸⁷ 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

⁸⁵ 15 U.S.C. 78q-1(b)(3)(F).

⁸⁶ 17 CFR 240.17Ad-22(e)(7)(vi)(A).

⁸⁷ 17 CFR 240.17Ad-22(e)(7)(viii).

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).⁸⁸

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

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

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.⁸⁹

Additionally, Rule 17Ad-22(e)(7)⁹⁰ 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)⁹¹ 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

⁸⁹ 15 U.S.C. 78q-1(b)(3)(F).

⁹⁰ 17 CFR 240.17Ad-22(e)(7).

⁹¹ Id.

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.⁹² Second, OCC proposes to amend Rule 1006(f) to permit OCC to reject a Clearing 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

⁹² 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.

resources in a timely fashion, thereby helping to promote 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 rule change is consistent with the requirements of Section 17A(b)(3)(F) of the Act.⁹³

Rule 17Ad-22(e)(7)⁹⁴ 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)⁹⁵ 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).⁹⁶

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

⁹³ 15 U.S.C. 78q-1(b)(3)(F).

⁹⁴ 17 CFR 240.17Ad-22(e)(7).

⁹⁵ 17 CFR 240.17Ad-22(e)(7)(ix).

⁹⁶ 17 CFR 240.17Ad-22(e)(7) and (e)(7)(ix).

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 assure the safeguarding 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.⁹⁷

Rule 17Ad-22(e)(18)⁹⁸ 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

⁹⁷ 15 U.S.C. 78q-1(b)(3)(F).

⁹⁸ 17 CFR 240.17Ad-22(e)(18).

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).⁹⁹

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 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. As a result, OCC believes the proposed changes are consistent with the requirements of Section 17A(b)(3)(F) of the Act¹⁰⁰ and Rule 17Ad-22(e)(7) thereunder.¹⁰¹

In addition, Rules 17Ad-22(e)(2)(i) and (v)¹⁰² require each covered clearing agency to establish, implement, maintain and enforce written policies and procedures

⁹⁹ Id.

¹⁰⁰ 15 U.S.C. 78q-1(b)(3)(F).

¹⁰¹ 17 CFR 240.17Ad-22(e)(7).

¹⁰² 17 CFR 240.17Ad-22(e)(2)(i) and (v).

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).¹⁰³

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

Section 17A(b)(3)(I) of the Act¹⁰⁴ 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 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 of the purposes of the Act, is described in detail below.

1. Liquidity Risk Management Framework

¹⁰³ Id.

¹⁰⁴ 15 U.S.C. 78q-1(b)(3)(I).

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.¹⁰⁵ 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

¹⁰⁵ See supra notes 22 and 22 and associated text.

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' 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 e-mail to 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 e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of OCC and on OCC's website at <https://www.theocc.com/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 [insert date 21 days from publication in the Federal Register].

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

Secretary

¹⁰⁶ 17 CFR 200.30-3(a)(12).

EXHIBIT 5A



OCC Rules

Underlined text indicates new text

~~Strikethrough~~ text indicates deleted text

Chapter III – Financial Requirements

RULE 301 – Initial Requirements

(a) - (c) [no changes]

(d) Every Clearing Member shall have access to sufficient financial resources to meet obligations arising from clearing membership in extreme but plausible market conditions, as determined by the Corporation for purposes of this Rule. Every Clearing Member shall also 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.

* * *

Chapter VI - Margins

* * *

RULE 601 - Margin Requirements

(a) - (f) [no changes]

(g) Required Cash Deposits. In cases when the Corporation forecasts that a Clearing Member's potential settlement obligations, including potential settlement obligations under stressed market conditions, could be in excess of the Corporation's liquidity resources available to satisfy such obligations, the Corporation may require such Clearing Member to satisfy all or part of its margin requirement calculated in accordance with this Rule 601 with cash (as set forth in Rule 604(a)). The Corporation generally requires funding of Required Cash Deposits five business days before the date of the projected settlement obligation but may require funding up to 20 business days before the projected date as facts and circumstances warrant.

...Interpretations and Policies:

.01 - .07 [no changes]

.08 For purposes of determining whether a Clearing Member's forecasted settlement obligations to the Corporation could exceed the liquidity resources available to the Corporation to satisfy such obligations, the Corporation shall 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.

* * *

RULE 604 - Form of Margin Assets

(a) – (f) [no changes]

(g) The Corporation may, in its discretion, require Clearing Members to deposit a specified amount of cash to satisfy its margin requirements as a protective measure if such 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. 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.

* * *

RULE 608 - Withdrawals of Margin

In the event that the amount of a Clearing Member’s margin on deposit exceeds the amount required on a particular day, as reported by the Corporation for such day, the Corporation shall authorize the withdrawal of the amount of the excess upon the submission to the Corporation by the Clearing Member between such times as the Corporation may specify of a withdrawal request in such form as the Corporation shall prescribe. Notwithstanding the foregoing, (a) a Clearing Member may not withdraw margin in any form or currency in an amount in excess of the amount of margin of that form or currency deposited in the account from which the withdrawal is made, (b) a Clearing Member may not withdraw margin in any form or currency if such withdrawal ~~would result in the Clearing Member’s reasonably anticipated~~ forecasted settlement obligations to the Corporation, including potential settlement obligations under stressed market conditions, exceeding the liquidity resources available to satisfy such ~~settlement obligations, as determined by the Corporation in its discretion, and (c) the Corporation may, if it deems it advisable for any of the reasons described in Rule 609, reject any withdrawal request. In the event of any such rejection, credit shall continue to be given for any margin deposit in respect of which withdrawal was rejected until such time as the withdrawal of such margin deposit is authorized.~~

Interpretations and Policies:

.01 [no changes]

.02 For purposes of determining whether a Clearing Member’s ~~reasonably anticipated~~ forecasted settlement obligations to the Corporation w~~ould~~ exceed the liquidity resources available to the Corporation to satisfy such obligations, the Corporation shall 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 ~~and may, in its discretion, consider the amount remaining on deposit with respect to such Clearing Member’s account that are in the form of U.S. Government securities and/or the Corporation’s other~~

~~available liquidity resources. In situations in which the anticipated/forecasted settlement obligations exceed the liquidity resources available to satisfy such obligations, the Corporation shall reject a withdrawal of margin assets in the form of U.S. dollars and, if it has considered such assets in calculating the Corporation's liquidity resources, in the form of U.S. Government securities.~~

* * *

RULE 609 - Intra-Day Margin

(a) Margin Calls. The Corporation may require the deposit of such additional margin (“intra-day margin”) by any Clearing Member in any account at any time during any business day, as such officer deems advisable to reflect changes in (i) the market price during such day of any series of options held in a short position in such account or of any underlying interest underlying any cleared contract (including an exercised option) in such account or of any Loaned Stock that is the subject of a stock loan or borrow position in such account, (ii) the size of such Clearing Member's positions in cleared contracts or stock loan or borrow positions, (iii) the value of securities deposited by the Clearing Member as margin, (iv) the financial position of the Clearing Member, or otherwise to protect the Corporation, other Clearing Members or the general public, or (v) stress test exposures such that a Sufficiency Stress Test (as defined in Rule 1001(a)) identifies an exposure that exceeds 75% of the current Clearing Fund requirement less deficits. ~~Additionally, the Corporation shall require the deposit of intra-day margin by a Clearing Member in the event that the Corporation, in its discretion, determines that the Clearing Member's reasonably anticipated settlement obligations to the Corporation would exceed the liquidity resources available to satisfy such settlement obligations.~~ A Clearing Member shall satisfy a required deposit of intra-day margin in immediately available funds within the time prescribed by such officer or, in the absence thereof, within one hour of the Corporation's issuance of an instruction debiting the applicable bank account of the Clearing Member.

(b) Required Cash Deposits. The Corporation may require the deposit of intra-day margin by a Clearing Member in the form of required cash in the event that the Corporation, in its discretion, determines that the Clearing Member's forecasted settlement obligations, including potential settlement obligations under stressed market conditions, could exceed the liquidity resources available to satisfy such obligations. Any deposit of intra-day margin pursuant to preceding sentence shall be satisfied within one hour of the Corporation's issuance of an instruction debiting the applicable bank account of the Clearing Member unless the Clearing Member is notified by an officer of the Corporation of an alternative time to satisfy such obligation. The Corporation generally requires funding of Required Cash Deposits five business days before the date of the projected settlement obligation but may require funding up to 20 business days before the projected date as facts and circumstances warrant.

. . . Interpretations and Policies

.01 For purposes of determining whether a Clearing Member's ~~reasonably anticipated/forecasted~~ settlement obligations to the Corporation ~~w~~ould exceed the liquidity resources available to the

Corporation to satisfy such ~~settlement~~ obligations, the Corporation shall consider, as forecasted settlement obligations, including but not limited to, 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 account Clearing Member or Clearing Member Group that are in the form of U.S. dollars ~~and may, in its discretion, consider the amount remaining on deposit with respect to such Clearing Member's account that are in the form of U.S. Government securities and/or the Corporation's other available liquidity resources.~~

* * *

Chapter X - Clearing Fund Contributions

* * *

RULE 1001 - Size of Clearing Fund

(a) [no changes]

(b) *Minimum Clearing Fund Size.* Notwithstanding paragraph (a) of this Rule 1001, in no event shall the size of the Clearing Fund be less than 110% of the size of the committed liquidity facilities of the Corporation plus the ~~Cash~~ Clearing Fund Cash Requirement (as defined in Rule 1002(a)).

(c) [no changes]

(d) *Temporary Increase to Clearing Fund Size.* ~~The Risk Committee, or the Executive Chairman, Chief Executive Officer, or Chief Operating Officer, upon notice to the Risk Committee,~~ Corporation shall have the authority to increase the size of the Clearing Fund at any time for the protection of the Corporation, Clearing Members or the general public. Any such ~~determination by the Executive Chairman, Chief Executive Officer, or Chief Operating Officer~~ to implement a temporary increase in Clearing Fund size would (i) be based upon then-existing facts and circumstances, (ii) be in furtherance of the integrity of OCC and the stability of the financial system, and (iii) take into consideration the legitimate interests of Clearing Members and market participants. Any temporary increase in the Clearing Fund shall be reviewed by the Risk Committee as soon as practical and, if such temporary increase is still in effect, the Risk Committee shall determine whether (A) the increase in the ~~cash~~ Clearing Fund Cash Requirement is no longer required, or (B) OCC's rules should be modified to ensure that OCC continues to maintain sufficient prefunded financial resources

RULE 1002 - Clearing Fund Contributions

(a) *Form and Method of Contributions.* Contributions to the Clearing Fund shall be in cash or in Government securities.

(i) ~~Cash Clearing Fund Cash Requirement.~~ ~~Clearing Members shall collectively contribute \$3 billion in cash to the Clearing Fund (“Cash Clearing Fund Requirement”).~~ ~~The Corporation shall periodically set a minimum cash requirement for the Clearing Fund (“Clearing Fund Cash Requirement”) based on analysis of the Corporation’s projected liquidity demands under a variety of stress scenarios; provided that the Clearing Fund Cash Requirement shall not be less than \$3 billion.~~ Each Clearing Member’s proportionate share of the ~~Cash Clearing Fund Cash Requirement~~ shall be equal in percentage to its proportionate share of the Clearing Fund as determined by Rule 1003(a)(y).

~~(A) Temporary Increases in Clearing Fund Cash Requirement.~~ ~~The Executive Chairman, Chief Executive Officer, or Chief Operating Officer, upon providing notice to the Risk Committee, Corporation shall have the authority to temporarily increase the amount of cash required to be maintained in the Clearing Fund, up to an amount that includes the size of the Clearing Fund as determined in accordance with Rule 1001, to respond to changing business or market conditions for the protection of OCC, Clearing Members or the general public in accordance with the Corporation’s policies and procedures. Any determination by the Executive Chairman, Chief Executive Officer, or Chief Operating Officer to implement a temporary increase in the Cash Clearing Fund Requirement 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. Any temporary increase in the Cash Clearing Fund Cash Requirement shall 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.~~

(ii) *Government Securities.* For purposes of valuing Government securities for calculating contributions to the Clearing Fund, Government securities shall be valued at (1) 99.5% of the current market value for maturities less than one year; (2) 98% of the current market value for maturities between one and five years; (3) 96.5% of the current market value for maturities between five and ten years; and (4) 95% of the current market value for maturities in excess of ten years. For the purposes of this Rule, the current market value of Government securities shall be determined by the Corporation at such intervals as the Risk Committee shall from time to time prescribe, but not less often than monthly, on the basis of the quoted bid price therefor supplied by a source designated by the Corporation. Contributions of Government securities shall be deposited by the Clearing Member in an account of the Corporation in an approved custodian in the name of the Corporation or by such other method as the Corporation may from time to time approve.

(iii) *Assets Denominated in a Foreign Currency.* Notwithstanding any other provision of this Rule 1002 in determining the U.S. dollar amount of clearing fund credit to be given to any foreign currency or asset denominated in a foreign currency, the Corporation may use such exchange rates and apply such “haircuts” as it deems appropriate for its protection.

(iv) Clearing Fund Collateral Substitutions. The Corporation generally requires a two-day notification 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; provided that, the Corporation may, in its discretion, waive the two-day notification period if the substitution would not result in any Clearing Member's settlement obligations to the Corporation, including potential settlement obligations under stressed market conditions, exceeding the liquidity resources available to satisfy such settlement obligations. 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.

(b) – (f) [no changes]

... Interpretations and Policies:

.01 – .02 [no changes]

03. For purposes of Rule 1002(a)(i), a Clearing Member shall satisfy any increase in its required cash contribution pursuant to an increase in ~~Cash~~ Clearing Fund Cash Requirement no later than ~~one hour before the close of the Fedwire on the business day following the Corporation's issuance of an instruction to increase cash contributions~~ the second business day following the day on which notice is provided by the Corporation unless the Clearing Member is notified by an officer of the Corporation of an alternative time to satisfy such obligation.

* * *

RULE 1006 - Purpose and Use of Clearing Fund

(a) Conditions for Clearing Fund Use. The Clearing Fund may be used for borrowings pursuant to the authority in Rule 1006(f). The Clearing Fund may also be used to make good losses or expenses suffered by the Corporation, or losses suffered by the Clearing Fund resulting from borrowings pursuant to the authority in Rule 1006(f); (i) as a result of the failure of any Clearing Member to discharge duly any obligation on or arising from any confirmed trade accepted by the Corporation, (ii) as a result of the failure of any Clearing Member (including any Appointed Clearing Member) or of CDS to perform its obligations (including its obligations to the correspondent clearing corporation) under or arising from any exercised or assigned option contract or matured future or any other contract or obligation issued, undertaken, or guaranteed by the Corporation or in respect of which the Corporation is otherwise liable, (iii) as a result of the failure of any Clearing Member to perform any of its obligations to the Corporation in respect of the stock loan and borrow positions of such Clearing Member, (iv) in connection with any liquidation of a Clearing Member's open positions, (v) in connection with protective transactions effected for the account of the Corporation pursuant to Chapter XI of the Rules, (vi)

as a result of the failure of any Clearing Member to make any other required payment or render any other required performance, or (vii) as a result of the failure of any bank or securities or commodities clearing organization to perform its obligations to the Corporation for reasons specified in paragraph (c) of this Rule 1006, ~~or (viii) as a result of a borrowing by the Corporation for liquidity needs for same day settlement pursuant to the authority in Rule 1006(f).~~ Notwithstanding the foregoing, in the event that the Corporation performs a Voluntary Tear-Up or a Partial Tear-Up pursuant to Rule 1111, the Clearing Fund may be used to provide compensation to non-defaulting Clearing Members and their customers as a means of re-allocating the losses, costs and fees imposed upon them as a result of such Voluntary Tear-Up or Partial Tear-Up, but only to the extent that such losses, costs and fees can be reasonably determined by the Corporation.

(b) [no changes]

(c) *Bank or Clearing Organization Failures.* (i) If any bank or securities or commodities clearing organization shall fail to perform any obligation to the Corporation when due because of its bankruptcy, insolvency, receivership, suspension of operations, or any similar event, and the Corporation shall sustain a loss (whether directly or as a trustee, custodian, or secured party) by reason thereof that is not recoverable out of the Clearing Fund pursuant to paragraph (b), the Corporation may, in its discretion, reimburse itself for such loss out of the Clearing Fund pursuant to this paragraph (c), and the amount of any such reimbursement shall be charged proportionately against all Clearing Members' required contributions to the Clearing Fund as calculated at the time.

(ii) With respect to any borrowing by the Corporation for liquidity needs for same day settlement pursuant to the authority in paragraph (e) of this Rule, ~~if such borrowing remains outstanding for a period of less than thirty days, the Corporation may, in its discretion, consider such amount an actual loss to the Clearing Fund and the amount of any such loss shall be charged proportionately against all Clearing Members' required contributions to the Clearing Fund as calculated at the time, provided however, that if such borrowing remains outstanding on the thirtieth day, the Corporation shall consider such amount an actual loss to the Clearing Fund and whenever such amount is considered an actual loss pursuant to paragraph (f) the amount of any such loss shall be charged proportionately against all Clearing Members' required contributions to the Clearing Fund as calculated at the time.~~

(iii) For purposes of this Rule 1006(c), the share of any deficiency to be borne by each Clearing Member (other than the suspended Clearing Member(s)) shall be a fraction, the numerator of which shall be the sum of the fixed amount and variable amount calculated pursuant to Rule 1003 for such Clearing Member (or its initial contribution if applicable) and the denominator of which shall be the sum of the fixed amounts, variable amounts and any initial contributions across all Clearing Members (other than the suspended Clearing Member(s)). To the extent that a loss resulting from any of the events referred to in this paragraph is recoverable out of the Clearing Fund pursuant to paragraph (b), the provisions of paragraph (b) shall control, and this paragraph (c) shall be inapplicable

(d) – (e) [no changes]

(f) *Borrowings.* ~~If~~The Corporation may take possession of cash or securities deposited by Clearing Members as contributions to the Clearing Fund and securities in which cash contributions to the Clearing Fund have been invested by the Corporation and use such assets to meet obligations, losses and/or liquidity needs arising from the circumstances described in (i) through (iii) below or to borrow or otherwise obtain funds through any means determined to be reasonable by the Executive Chairman, Chief Executive Officer or the Chief Operating Officer of the Corporation in his discretion (including, without limitation, pledging such assets as security for loans and/or using such assets to effect repurchase, securities lending or other transactions) if: (i) the Corporation deems it necessary or advisable to borrow or otherwise obtain funds ~~from third parties~~ in order to meet obligations arising out of the default or suspension, or in anticipation of the potential default or suspension, of a Clearing Member or any action taken by the Corporation in connection therewith pursuant to Chapter XI of the Rules or otherwise; ~~or~~ (ii) the Corporation sustains a loss reimbursable out of the Clearing Fund pursuant to paragraph (c) but elects to borrow or otherwise obtain funds ~~from third parties~~ in lieu of immediately charging such loss to the Clearing Fund; or (iii) the Corporation reasonably 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 to achieve daily settlement, ~~and in any case the Corporation determines that it will be unable to borrow or otherwise obtain such funds on acceptable terms on an unsecured basis; then the Corporation may take possession of cash or securities deposited by Clearing Members as contributions to the Clearing Fund and securities in which cash contributions to the Clearing Fund have been invested by the Corporation and use such assets to borrow or otherwise obtain funds through any means determined to be reasonable by the Executive Chairman, Chief Executive Officer, or the Chief Operating Officer of the Corporation in his discretion (including, without limitation, pledging such assets as security for loans and/or using such assets to effect repurchase, securities lending or other transactions); provided, in~~ To the extent the Corporation has borrowed or otherwise obtained funds using securities deposited by Clearing Members as contributions to the Clearing Fund or securities in which cash contributions to the Clearing Fund have been invested, the Corporation may refuse any Clearing Member substitution request regarding such securities. In the case of any such borrowing or transaction effected under the circumstances specified in clause (i) or clause (iii) above, that the funds obtained through such transaction will be used solely for the purposes described in clause (i) or clause (iii), as applicable. The funds obtained by the Corporation pursuant to this paragraph (f), irrespective of how such funds are applied, shall not be deemed to be charges 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 this Chapter X. If all or a part of any borrowing of cash from the Clearing Fund or any transaction effected by the Corporation pursuant to this paragraph (f) is thereafter determined by the Corporation, in its discretion, on any Business Day, to represent an actual loss to the Clearing Fund, a loss to the Corporation reimbursable out of the Clearing Fund, or all or a part of any such transaction remains outstanding after thirty days (or on the first Business Day thereafter if the thirtieth calendar day is not a Business Day), the Corporation, at the close of business of the thirtieth day (or on the first Business Day thereafter), on such Business Day shall consider the amount of Clearing Fund assets used to

support the Corporation's obligations under the outstanding borrowing or transaction as an actual loss to the Clearing Fund and immediately allocate such loss in accordance with this Chapter X.

* * *