OCC THE FOUNDATION FOR SECURE MARKETS®

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September 11, 2024

VIA CFTC PORTAL

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

Re: Rule Certification by The Options Clearing Corporation Concerning Updates to OCC's Capital Management Policy

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, The Options Clearing Corporation ("OCC") hereby certifies a rule change concerning updates to OCC's Capital Management Policy. The date of implementation of the rule is at least 10 business days following receipt of the certification by the CFTC. The proposal has also been submitted to the Securities and Exchange Commission ("SEC") under Section 19(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 19b-4 thereunder as File No. SR-OCC-2024-012. The change will not be implemented until OCC has obtained all necessary regulatory approvals.

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

<u>Explanation and Analysis</u>

The purpose of this rule certification is to: (1) revise OCC's Capital Management Policy to update its plan for raising additional capital ("Replenishment Plan") should OCC experience potential general business losses, (2) amend OCC's schedule of fees necessary to reflect the proposed change in OCC's Capital Management Plan, and (3) update OCC Rule 101 to maintain consistency with the proposed change in OCC's Capital Management Policy.

Proposed changes to OCC's Capital Management Policy are included in confidential Exhibit A. Proposed changes to OCC's schedule of fees and Rule 101 are included in Exhibits B and C respectively. Material proposed to be added is marked by underlining and material proposed to be deleted is marked in strikethrough text. All capitalized terms not defined herein have the same meaning as set forth in the OCC By-Laws and Rules.[1]

Overview

OCC's Capital Management Policy was adopted in 2019, and it establishes the principles used to quantify, monitor and manage the level of OCC's Equity[2] such that OCC maintains liquid net assets funded by equity ("LNAFBE")[3] to cover potential general business losses and continue operations and services as a going concern if losses materialize under a range of scenarios, including adverse market conditions.

A main component of the Capital Management Policy is OCC's plan to replenish its capital in the event it falls close to or below its target capital (as defined below, "Replenishment Plan"), as required by SEC Rule 17Ad-22(e)(15)(iii).[4] This rule provides that OCC must maintain a "viable plan, approved by the board of directors and updated at least annually, for raising additional Equity should its Equity fall close to or below the amount required under SEC Rule 17Ad-22(e)(15)(ii)."[5] In satisfaction with SEC Rule 17Ad-22(e)(15)(iii), OCC's Replenishment Plan establishes a plan for accessing additional capital should OCC's Equity fall below certain thresholds.

OCC's existing Replenishment Plan provides that (i) should OCC's Equity less the Minimum Corporate Contribution fall below 110% of the Target Capital Requirement (as defined by the Capital Management Policy, "Early Warning"), Management would recommend to the Board whether to implement a fee increase in an amount the Board determines necessary and appropriate to raise additional Equity; (ii) should OCC's Equity less the Minimum Corporate Contribution fall below 90% of the Target Capital Requirement or fall below the Target Capital Requirement for a period of ninety consecutive days (as defined in the Capital Management Policy, "Trigger Event"), OCC would contribute the funds held under OCC's Executive Deferred Compensation Plan Trust which are (a) deposited on and after January 1, 2020 in respect of the Corporation's Executive Deferred Compensation Plan ("EDCP") and (b) in excess of amounts necessary to pay for the

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1 https://www.theocc.com/Company-Information/Documents-and-Archives/By-Laws-and-Rules.

2 The Capital Management Policy defines "Equity" as shareholders' equity as shown on OCC's Statement of Financial Condition.

3 The Capital Management Policy defines "LNAFBE" as the level of cash and cash equivalents, no greater than Equity, less any approved adjustments (i.e., agency-related liabilities such as Section 31 fees held by OCC and the Minimum Corporate Contribution).

4 17 CFR 240.17Ad-22(e)(15)(iii).

5 Id. (emphasis added).

benefits accrued and vested under the EDCP as of such date (defined in Chapter 1 of OCC's Rules as "EDCP Unvested Balance"); and (iii) should the contribution of the EDCP Unvested Balance fail to cure the Trigger Event, or if a further Trigger Event occurs, OCC will charge an Operational Loss Fee in equal shares to the Clearing Members.

OCC's existing Replenishment Plan states that in the event of a Trigger Event, OCC will first contribute the funds necessary to cure such loss with the EDCP Unvested Balance. If the loss cannot be cured after applying all available EDCP Unvested Balance, OCC will then charge an Operational Loss Fee in equal share to each Clearing Member.

The purpose of this proposed rule change is to revise the Replenishment Plan in the Capital Management Policy so that the Early Warning and Trigger Event are measured against LNAFBE rather than Equity. At the time the Capital Management Policy was adopted, LNAFBE and Equity were much closer in size than they are currently. Given the growing difference between Equity and LNAFBE, it is possible that in the event of an operational loss, LNAFBE may fall below the Target Capital Requirement, but Equity would remain above the Early Warning and Trigger Event. In that instance, OCC would not be able to access the Operational Loss Fee to bring LNAFBE above the Target Capital Requirement because OCC's Equity would still be above the Trigger Event. Consequently, OCC proposes to amend the Replenishment Plan in the Capital Management Policy such that the Early Warning and Trigger Event are measured against LNAFBE, rather than Equity. As defined in the Capital Management Policy, LNAFBE will always be less than or equal to Equity. By amending the Replenishment Plan in the Capital Management Policy so that the Early Warning and Trigger Event are measured against LNAFBE, rather than Equity, OCC will have the ability to access its Replenishment Plan, including the Operational Loss Fee, in the event its LNAFBE falls below regulatory minimums.

To implement the proposed changes in the Replenishment Plan in the Capital Management Policy, OCC also proposes to update its schedule of fees to revise the Operational Loss Fee such that OCC would charge the Operational Loss Fee if OCC's LNAFBE falls below the Trigger Event.

<u>Proposed Changes</u>

As described in detail below, OCC proposes to revise the Replenishment Plan under its Capital Management Policy so that the Early Warning and Trigger Event are measured against LNAFBE, rather than Equity. OCC also proposes to make conforming changes to its schedule of fees necessary to implement the proposed changes in the Replenishment Plan to promote compliance with SEC Rule 17Ad-22(e)(15)(iii).

In addition, OCC proposes to incorporate several non-substantive changes to the Capital Management Policy, including updating the header text at the beginning of the document to incorporate additional sections to promote clarity and consistency for document use and management. Specifically, OCC's proposed changes add the following sections to the header at the beginning of the document: (i) Policy Owner, (ii) Document Type, (iii) Board Approval, (iv) Rule Filed, and (iv) Version Number. To promote additional clarity, OCC's proposed changes also add the term "version" prior to the header labeled as "effective date." Finally, OCC's proposed changes eliminate the header labeled as "scope" as OCC believes this section is unnecessary for document use and management.

Replenishment Plan

i. Early Warning

OCC would revise the Replenishment Plan's Early Warning so that it is measured against LNAFBE. Specifically, the Capital Management Policy would define the Early Warning to be when LNAFBE, rather than Equity less the Minimum Corporate Contribution, falls below 110% of the Target Capital Requirement.[6] OCC proposes replacing Equity with LNAFBE within the Capital Management Policy to reflect this change to the Early Warning as well as the change to the definition of Trigger Event described below. After this replacement, the Capital Management Policy would explain that in the event of an operational loss, OCC would first use LNAFBE, rather than Equity less the Minimum Corporate Contribution, above 110% of Target Capital. The proposed changes would further describe that in the event OCC's LNAFBE, rather than equity, breaches the Early Warning, Management would recommend to the Board whether to implement a fee increase in an amount the Board determines necessary and appropriate to raise additional LNAFBE, rather than Equity. The recommendation whether to implement the fee increase would be informed by several factors including, but not limited to, the facts, circumstances and root cause of a decrease in LNAFBE, rather than Equity, below the Early Warning.

ii. Trigger Event

OCC would further revise the Replenishment Plan's Trigger Event so that it is measured against LNAFBE. Specifically, the Capital Management Policy would define a Trigger Event to be

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6 OCC's Capital Management Policy explains how OCC sets its Target Capital Requirement, including how OCC may set its Target Capital Requirement to retain "additional Equity generated from revenue." To conform with the proposed changes, OCC proposes to modify those references to "additional Equity generated from revenue, in the form of LNAFBE." Specifically, OCC's proposed changes would clarify that OCC can retain additional Equity generated from revenue, in the form of LNAFBE, for capital expenditures following a recommendation by Management and Board approval. OCC's proposed changes would also clarify that the Board would (a) determine if the capital needs are necessary and appropriate and, if so, (b) determine whether to (i) increase the Target Capital Requirement or (ii) retain the additional Equity, in the form of LNAFBE, as an amount in excess of the Target Capital Requirement.

when OCC's LNAFBE, rather than Equity less the Minimum Corporate Contribution, falls below 90% of the Target Capital Requirement or remains below the Target Capital Requirement for ninety consecutive calendar days. If a Trigger Event occurs, OCC would first contribute the funds necessary to cure such loss with the EDCP Unvested Balance. To reflect the new definition of Trigger Event, the Capital Management Policy would be changed to explain that if OCC's LNAFBE, rather than Equity, remains below 90% of the Target Capital Requirement after applying the EDCP Unvested Balance, or if a further Trigger Event occurs after applying all available EDCP Unvested Balance, OCC would charge an Operational Loss Fee[7] in equal share to each Clearing Member payable on five business days' notice, to raise additional capital. The Capital Management Policy would be edited to provide that, in the event less than the full amount of the maximum Operational Loss Fee is needed to return OCC's LNAFBE, rather than Equity, to 110% of the Target Capital Requirement, OCC would charge only that amount necessary to return OCC's LNAFBE, rather than Equity, to 110% of the Target Capital Requirement. This change better ensures that OCC holds the mandated amount of LNAFBE. The proposed changes to the Capital Management Policy would also remove the term "threshold" after Early Warning and Trigger Event where the Early Warning and Trigger Event already incorporate that concept and clarify that Trigger means Trigger Event in the Replenishment Plan.

Capital Monitoring

OCC proposes to update the heading of section B in confidential Exhibit A from "Monitoring Equity Levels" to "Capital Monitoring" to more closely align with the other headings throughout this document, and clarify the information that is described in this section. The Capital Management Policy describes how Management reviews periodic analyses of LNAFBE, including projecting future volume, expenses, cash flows, capital needs and other factors to help ensure adequate financial resources are available to meet general business obligations. The proposed changes to the Capital Management Policy would provide that Management also reviews an analysis of LNAFBE, as opposed to Equity,[8] at least monthly to ensure: (i) an Early Warning has not occurred or is not reasonably expected to occur prior to the next review; and (ii) a Trigger Event has not occurred and is not expected to occur prior to the next review. The Capital Management Policy would explain that at each regularly scheduled Board and Compensation and Performance Committee ("CPC")

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[7] OCC has outlined when the Operational Loss Fee can be charged in OCC's Schedule of Fees in Exhibit B.

[8] Separately from the Capital Management Policy's measurement of LNAFBE against the Early Warning and Trigger Event, OCC also reviews its Equity on an at-least monthly basis for purposes of measuring its financial resources, including OCC's own capital and any other financial resources deemed acceptable by the CFTC, to satisfy the CFTC's requirement that OCC cover its operating costs for a period of at least one year on a rolling basis. See 17 CFR 39.11(a)(2).

meeting, the Chief Financial Officer ("CFO") would report on the firm's LNAFBE, rather than Equity, relative to the Target Capital Requirements, Early Warning and Trigger Event. The Capital Management Policy would also provide that if OCC suffers a catastrophic or sizable loss during the month, and such loss amount is known or can reasonably be estimated, Management should review a forecast of the impact on LNAFBE, rather than Equity. Finally, the Capital Management Policy would state that if such forecast demonstrates that LNAFBE, rather than Equity, has fallen below the Early Warning or Trigger Event, Management should promptly notify the Board.

Capital Management

In addition to the Replenishment Plan, the Capital Management Policy also addresses certain actions the Board may take based on, and which impact, the level of OCC's Equity or LNAFBE, including the circumstances under which the Board may consider using tools to lower Clearing Members' cost of participation such as through a fee decrease, fee hold and fee refund. Consistent with the changes to measure the aforementioned thresholds against LNAFBE, OCC would amend the Capital Management Policy to provide that the Board may only use such tools if LNAFBE, rather than Equity, is above 110% of the Target Capital Requirement. In practice, OCC would not have taken such measures if its LNAFBE was below 110% of the Target Capital Requirement. This change would clearly express that practice in the Capital Management Policy.

Proposed Changes to OCC Rule 101

Consistent with the proposed changes to the Capital Management Policy, OCC also proposes to amend the definition of "Target Capital Requirement" as defined in OCC Rule 101.[9] The Rules use that term to provide for the variable amount of skin-in-the-game (i.e., LNAFBE in excess of 110% of the Target Capital Requirement) that OCC would contribute to cover losses or liquidity shortfalls arising from a Clearing Member default under OCC Rule 1006 in specified circumstances. As described in Exhibit C, OCC proposes to replace the term "shareholders' equity" with "liquid net asses funded by equity ("LNAFBE")" within the definition of Target Capital Requirement. Revising the definition of Target Capital Requirement to refer to the level of LNAFBE, as opposed to shareholder's equity, would maintain consistency with the above referenced changes to OCC's Capital Management Policy.

Fee Schedule

OCC would also amend its fee schedule to reflect the conditions under which it would charge the Operational Loss Fee. As described in Exhibit B, OCC would charge the Operational Loss Fee in

[9] https://www.theocc.com/Company-Information/Documents-and-Archives/By-Laws-and-Rules

equal shares to Clearing Members to raise additional capital if OCC's LNAFBE, as opposed to Equity less the Minimum Corporate Contribution, falls below 90% of the Target Capital Requirement or below the Target Capital Requirement for a period of ninety consecutive calendar days, after first applying the unvested balance held in respect of OCC's EDCP. Furthermore, if less than the full amount of the maximum Operational Loss Fee is needed to return OCC's LNAFBE, as opposed to Equity, to 110% of the Target Capital Requirement, OCC would charge only that amount necessary to return OCC's LNAFBE to 110% of the Target Capital Requirement.

Consistency with DCO Core Principles

OCC reviewed the DCO core principles ("Core Principles") as set forth in the Act, the regulations thereunder, and the provisions applicable to a DCO that elects to be subject to the provisions of 17 CFR Subpart C ("Subpart C DCO"). During this review, OCC identified the following as potentially being impacted:

> **Financial Resources.** OCC believes that implementing the proposed rule change will be aligned with the requirements of Core Principle B, which requires, in part, that each DCO have adequate financial resources, as determined by the CFTC, to discharge its responsibilities, including financial resources.[10] Consistent with Core Principle B, CFTC Rule 39.11(a) provides that a DCO shall identify and adequately manage its general business risks and hold sufficient liquid resources that are not related to clearing members' defaults, so that the DCO can continue to provide services as an ongoing concern. [11]
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> OCC's Capital Management Policy is designed to ensure that OCC holds sufficient LNAFBE such that it could continue to promptly and accurately clear and settle securities transactions even if it suffered significant operational losses. Holding sufficient LNAFBE would help OCC to absorb such operational losses and avoid a disruption that could negatively impact OCC's prompt and accurate clearing and settlement of transactions. Furthermore, by maintaining sufficient LNAFBE, OCC will ensure adequate financial resources are available to meet general business obligations.
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> The amendments to the Replenishment Plan in the Capital Management Policy, OCC's schedule of fees, and OCC's Rules are reasonably designed to establish a viable plan to raise additional capital in an amount up to the amount the Board determines annually to be sufficient to ensure recovery or orderly wind-down should OCC's LNAFBE fall close to or below its Target Capital Requirements. In addition, by providing that the Early Warning and Trigger Event be measured against LNAFBE, rather than Equity, this will ensure that OCC

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[10] 7 U.S.C. 7a-1(c)(2)(B).

[11] 17 CFR 39.11(a)(2).

has access to its Replenishment Plan, including the Operational Loss Fee, to cover potential general business losses so that OCC can continue operations and services as a going concern if those losses materialize.

For these reasons, OCC believes that the proposed changes are consistent with the requirements of the DCO Core Principles and the CFTC Regulations thereunder.

Opposing Views

No substantive opposing views were expressed related to the rule amendments by OCC's Board members, Clearing Members or market participants. Public comments on the proposed rule change filed with the SEC, if any, and any OCC response to such comments may be viewed on the SEC's public website.[12]

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 this certification on OCC's website concurrently with the filing of this submission.

Certification

OCC hereby certifies that the rule set forth in confidential Exhibit A, Exhibit B and Exhibit C 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,

/s/ Megan Cahill
Assistant General Counsel
The Options Clearing Corporation

12 See Options Clearing Corporation (OCC) Rulemaking, https://www.sec.gov/rules/sro/occ.htm.

Enclosure: Confidential Exhibit A, Exhibit B, Exhibit C