

proposed rule change (SR-NYSEAMER-2017-26) be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>21</sup>

**Eduardo A. Aleman,**

*Assistant Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-82502; File No. SR-OCC-2017-019]

### Self-Regulatory Organizations; The Options Clearing Corporation; Order Approving Proposed Rule Change, as Modified by Amendment No. 1, Concerning The Options Clearing Corporation's Adoption of a New Minimum Cash Requirement for the Clearing Fund

January 12, 2018

#### I. Introduction

The Options Clearing Corporation ("OCC"), on November 14, 2017, filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change (SR-OCC-2017-019) to propose a new minimum cash contribution requirement for its Clearing Fund<sup>3</sup> ("Cash Clearing Fund Requirement") and also provide for the pass-through interest income earned on such deposits to its Clearing Members. On November 22, 2017, OCC filed Amendment No. 1 to the proposed rule change, which made clarifications regarding the calculation of the interest earned on deposits. The proposed rule change was published for comment in the **Federal Register** on December 1, 2017.<sup>4</sup> The Commission received two comments regarding the proposed change.<sup>5</sup> For the reasons discussed below, the Commission is approving the proposed rule change.

#### II. Description of the Proposed Rule Change

OCC maintains a Clearing Fund, composed of contributions required to be made by all Clearing Members, to satisfy losses suffered by OCC under a number of circumstances, including the default or failure of a Clearing Member to meet any obligation for which OCC may be responsible in the exercise of its duties as a central counterparty. Presently, Article VIII, Section 3(a) of OCC's By-Laws provides that Clearing Fund contributions shall be in the form of cash and Government securities, but neither OCC's By-Laws nor Rules provides a minimum cash requirement for contributions to the Clearing Fund. Article VIII, Section 4(a) of OCC's By-Laws allows for OCC to invest cash contributions to the Clearing Fund, partially or wholly, in OCC's account in Government securities, and to the extent that such contributions are not so invested, they shall be deposited by OCC in a separate account or accounts for Clearing Fund contributions in approved custodians. Article VIII, Section 4(a) of OCC's By-Laws, however, presently does not account for the treatment of interest earned on cash deposits held in OCC's bank account at the Federal Reserve.

##### A. Proposed Change To Establish the Cash Clearing Fund Requirement

OCC proposed to establish a Cash Clearing Fund Requirement for its Clearing Fund to increase the amount of qualifying liquid resources available to OCC to account for the event there is an extreme scenario in the financial markets and OCC has to address any resultant liquidity demands. Further, the proposal sought to ensure that OCC holds, and maintains access to, a more consistent level of cash clearing fund resources in its available prefunded financial resources. Specifically, the proposed rule change would require that Clearing Members collectively contribute \$3 billion in cash to the Clearing Fund. Each Clearing Member's proportionate share of the Cash Clearing Fund Requirement shall be determined by the current Clearing Fund allocation methodology in OCC Rule 1001.

OCC's current liquidity resources are sized to cover historically observed liquidity demands and potential demands based on forecasts with a 12 month time horizon. The sizing calculations, in turn, are based on the potential exposure resulting from the default of a single clearing member. Further, the current clearing fund is sized, at a minimum, to ensure that OCC maintains sufficient collateral to access

its committed liquidity facilities. OCC represented that it maintains committed liquidity facilities of \$3 billion to cover its calculated historical and forecasted demands.<sup>6</sup>

After analyzing its liquidity demands in extreme stress scenarios,<sup>7</sup> OCC determined that it would propose the \$3 billion Cash Clearing Fund Requirement to increase the amount and reliability of its liquid resources. OCC represented that, based upon its analysis, the peak stressed liquidity demands of the largest or two largest Clearing Members, which normally occur in conjunction with certain monthly expirations, could exceed the capacity of OCC's current committed liquidity facilities. Although OCC believes that it would be able to cover the resulting shortfall with cash already present in the Clearing Fund, OCC stated that it could not rely on such cash always being available because, under OCC's current By-Laws and Rules, there is no ability for OCC to ensure that a minimum amount of cash is maintained in the Clearing Fund at all times. As a result, OCC believes that the proposed \$3 billion Cash Clearing Fund Requirement, combined with OCC's \$3 billion of committed liquidity facilities, would provide liquid resources sufficient to cover the peak stressed liquidity demands of the largest one or two Clearing Members observed in the analysis.

##### B. Proposed Change To Allow Temporary Increase of Cash Clearing Fund Requirement

The proposed change would also provide authority for OCC to temporarily increase the amount of the Cash Clearing Fund Requirement. OCC's Executive Chairman, Chief Administrative Officer ("CAO"), or Chief Operating Officer ("COO"), would have the authority, upon providing notice to the Risk Committee, to temporarily raise the Cash Clearing Fund Requirement up to an amount that includes the size of the Clearing Fund

<sup>6</sup> See Exchange Act Release No. 81058 (June 30, 2017), 82 FR 31371 (July 6, 2017) (SR-OCC-2017-803); Exchange Act Release No. 76641 (Dec. 14, 2015), 80 FR 79114 (Dec. 18, 2015) (SR-OCC-2015-805). Both facilities allow OCC to obtain cash in exchange for Government securities 60 minutes after notice is given and collateral is posted.

<sup>7</sup> OCC represented that it performed an analysis of its stress liquidity demands based on a 1-in-70 year hypothetical market event. Specifically, OCC started its analysis by selecting the largest historical peak monthly settlements that occurred over the historical look-back period of data generated by the stress test system. It then also selected certain large non-expiration days to supplement the analysis. From this it estimated the mark-to-market and cash settled exercise and assignment obligations for the members driving the historical peak demand under the proposed stress tests scenario to determine the stressed peak demand.

<sup>21</sup> 17 CFR 200.30-3(a)(12).

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

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

<sup>3</sup> Unless specified otherwise, capitalized terms shall have the meaning OCC ascribes in its By-Laws and Rules.

<sup>4</sup> Exchange Act Release No. 82156 (Nov. 27, 2017), 82 FR 57015 (Dec. 1, 2017) (SR-OCC-2017-019) ("Notice").

<sup>5</sup> Two comment letters were submitted to the Commission expressing approval of the proposed rule change. See Letter from Rosa Beltran dated Nov. 28, 2017; Letter from Michael Kitlas dated Nov. 27, 2017.

as determined in accordance with Rule 1001 for the month in question. A Clearing Member will be required to satisfy any increase in its required cash contribution pursuant to an increase in the Cash Clearing Fund Requirement no later than one hour before the close of the Fedwire on the business day following OCC's issuance of an instruction to increase cash contributions.

In such circumstances, the Risk Committee, by rule, would be obligated to review any such temporary increase as soon as practicable, but in any event within 20 calendar days of the increase. In its review, the Risk Committee shall determine whether (1) the increase in the minimum Cash Clearing Fund Requirement is no longer required, or (2) OCC's Clearing Fund contribution requirements and other related rules should be modified to ensure that OCC continues to maintain sufficient liquid resources to cover its largest aggregate payment obligations in extreme but plausible market conditions. In the event that the Risk Committee would determine to permanently increase the Cash Clearing Fund Requirement, OCC would initiate any regulatory approval process required to effect such a change.<sup>8</sup>

OCC acknowledged that increasing the Cash Clearing Fund Requirement could impose a liquidity constraint on its clearing members. Accordingly, OCC has proposed to limit the circumstances in which it could make such an increase. By rule, OCC would only be able to exercise this authority to protect OCC, its clearing members, or the general public. Further, any Cash Clearing Fund Requirement increase would have to: (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.

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

#### *C. Proposed Changes to Pass-Through Interest on Clearing Fund Cash to Clearing Members*

Under the proposal, OCC stated that substantially all the cash deposits in the

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

To accommodate the pass through of interest income, OCC would also amend its Fee Policy to add definitions for "Pass-Through Interest Revenue" and "Operating Expenses" to exclude from the calculation of the Business Risk Buffer projected interest revenue and expense, respectively, related to the pass-through of earned interest from OCC to Clearing Members.<sup>9</sup> OCC also proposes to add a new example of the Business Risk Buffer calculation reflecting this change and make clarifying changes throughout the policy to incorporate the use of the new defined terms. In addition, OCC proposes to amend the Fee Policy to remove references to "Proposed Rule 17Ad-22(e)(15)" to reflect the adoption of the Commission's Covered Clearing Agency Standards.

#### *D. Proposed Conforming Changes*

In conjunction with the aforementioned changes, OCC is also proposing to make four related conforming changes. First, OCC proposes to revise Interpretation and Policy .01 of Rule 1001 to reflect that the new minimum Clearing Fund size is \$3 billion (instead of \$1 billion) plus 110% of the size of OCC's committed liquidity facilities, which conforms to the Cash Clearing Fund Requirement. Second, OCC proposes to amend the definition of "Approved Custodian" in Article I, Section 1 of the By-Laws to clarify that the Federal Reserve Bank may also be an Approved Custodian, to the extent it is available to OCC. Third, OCC is proposing to delete existing

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

### **III. Discussion and Commission Findings**

Section 19(b)(2)(C) of the Exchange Act directs the Commission to approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to such organization.<sup>10</sup> After carefully considering the proposed rule change and the two comment letters submitted, the Commission finds that the proposed rule change is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to OCC. More specifically, the Commission finds that the proposal is consistent with Section 17A(b)(3)(F) of the Exchange Act and Rule 17Ad-22(e)(7) under the Exchange Act.<sup>11</sup>

#### *A. Consistency With Section 17A(b)(3)(F) of the Exchange Act*

Section 17A(b)(3)(F) of the Exchange Act requires that the rules of a registered clearing agency be designed to do, among other things, promote the prompt and accurate clearance and settlement of securities transactions and, in general, protect investors and the public interest.<sup>12</sup> Based on the analysis provided by OCC, the Commission believes that OCC's conclusion is

<sup>8</sup> However, OCC represented that it would not decrease the Cash Clearing Fund Requirement while the regulatory approvals for a change in the Cash Clearing Fund Requirement are being obtained to ensure that OCC continues to maintain sufficient liquid resources to cover its liquidity demands during that time.

<sup>9</sup> While interest income earned by OCC from its bank account at the Federal Reserve would be passed on to its Clearing Members, OCC anticipates that it would charge a cash management fee to cover associated costs (i.e., administrative and similar costs). OCC would file a separate proposed rule change with the Commission, subject to receiving all necessary regulatory approvals for the proposed changes described herein, prior to implementing any cash management fee.

<sup>10</sup> 15 U.S.C. 78s(b)(2)(C).

<sup>11</sup> 15 U.S.C. 78q-1(b)(3)(F); 17 CFR 240.17Ad-22(e)(7).

<sup>12</sup> 15 U.S.C. 78q-1(b)(3)(F).

reasonable, *i.e.*, that under certain stressed conditions as set forth in the analysis, the peak stressed liquidity demands of the largest clearing member could exceed the size of OCC's committed liquidity facilities. Moreover, the Commission understands that OCC is unable to rely on the likelihood that there will always be deposits of cash in the Clearing Fund sufficient to cover such demands because, under its current By-laws and Rules, there is no ability for OCC to ensure that a minimum amount of cash is maintained in the Clearing Fund at all times. Therefore, there is a risk that OCC could face liquidity shortfalls in the event of a default by a clearing member whose payment obligations exceed OCC's liquid resources.

OCC determined to address this risk by proposing to establish the Cash Clearing Fund Requirement. Establishing the Cash Clearing Fund Requirement would provide OCC with more qualifying liquid resources, which, in turn, enhances OCC's ability to cover payment obligations that could arise in stressed conditions. Therefore, the Commission believes that this outcome would enhance OCC's ability to manage its liquidity risk exposure, thereby promoting prompt and accurate clearance and settlement of securities transactions.

Further, the proposal to give OCC the authority to temporarily increase the Cash Clearing Fund Requirement gives OCC additional means to address liquidity shortfalls in extreme scenarios. Therefore, the Commission believes that increasing the amount of cash, and thus the overall amount of qualifying liquid resources, available to cover OCC's liquidity demands arising in stressed scenarios is consistent with the promotion of prompt and accurate clearance and settlement of securities transactions.

OCC is the sole registered clearing agency for the U.S. listed options markets. As such, it is important for OCC to implement measures that enhance its ability to manage risks that could cause a financial loss or settlement disruption and threaten the stability of the U.S. listed options markets and the broader financial system. The Commission believes that the proposed change is designed to enhance OCC's ability to continue to make timely settlement of payment obligations and otherwise service the U.S. options markets while in the midst of experiencing an extreme market event in the form of the default of up to two of its largest clearing members. As such,

the Commission believes the proposed change is consistent with the protection of investors and the public interest.

Accordingly, the Commission finds that the proposed rule change is consistent with Section 17A(b)(3)(F) of the Exchange Act.<sup>13</sup>

#### *B. Consistency With Rule 17Ad-22(e)(7) of the Exchange Act*

The Commission further believes that the proposed change is consistent with Rule 17Ad-22(e)(7) under the Exchange Act, which requires that a covered clearing agency establish, implement, maintain and enforce written policies and procedures reasonably designed to effectively measure, monitor, and manage its liquidity risk.<sup>14</sup> This includes measuring, monitoring, and managing the covered clearing agency's settlement and funding flows on an ongoing and timely basis, as well as its use of intraday liquidity.<sup>15</sup> The Commission believes that the proposed change is consistent with several particular sub-parts of Rule 17Ad-22(e)(7), which require that OCC's liquidity risk management policies and procedures be reasonably designed to achieve the following:

- Maintaining 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 covered clearing agency in extreme but plausible market conditions;<sup>16</sup>
- using the access to accounts and services at a Federal Reserve Bank or other relevant central bank, when available and where the board of directors of the covered clearing agency has determined that it would be practical to enhance its management of liquidity risk;<sup>17</sup> and
- addressing foreseeable liquidity shortfalls that would not be covered by a covered clearing agency's liquid resources and seeking to avoid unwinding, revoking, or delaying the same-day settlement of payment obligations.<sup>18</sup>

<sup>13</sup> 15 U.S.C. 78q-1(b)(3)(F).

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

<sup>15</sup> 17 CFR 240.17Ad-22(e)(7).

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

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

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

By proposing the Cash Clearing Fund Requirement and increasing the amount of qualifying liquid resources available to cover OCC's liquidity demands arising in stressed scenarios, OCC has taken measures consistent with the requirement in Rule 17Ad-22(e)(7)(i) that it maintain sufficient liquid resources to effect settlement of its payment obligations with a high degree of confidence under a wide range of foreseeable stress scenarios. OCC also represented that substantially all of OCC's Clearing Fund deposits consisting of cash would be held in an account established by OCC at a Federal Reserve Bank and further clarified that interest earned in such an account would be paid to its members on a specified basis. By proposing to use its access to accounts at a Federal Reserve Bank to support the maintenance of the Cash Clearing Fund Requirement, OCC has taken measures consistent with the requirement in Rule 17Ad-22(e)(7)(iii) which provides for using access to a central bank account, where available and determined to be practical. Further, the proposed authority to temporarily increase the Cash Clearing Fund Requirement is intended to allow OCC to address a foreseeable liquidity shortfall and is therefore consistent with the requirement in Rule 17Ad-22(e)(7)(viii) addressing such shortfalls.

#### **IV. Conclusion**

On the basis of the foregoing, the Commission finds that the proposed change is consistent with the requirements of the Exchange Act, and in particular, with the requirements of Section 17A of the Exchange Act<sup>19</sup> and the rules and regulations thereunder.

*It is therefore ordered* pursuant to Section 19(b)(2) of the Exchange Act that the proposed rule change (SR-OCC-2017-019), as modified by Amendment No.1, be, and hereby is, approved.

For the Commission by the Division of Trading and Markets, pursuant to delegated authority.<sup>20</sup>

**Brent J. Fields,**

*Secretary.*

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<sup>19</sup> In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>20</sup> 17 CFR 200.30-3(a)(12).