

below, the Commission seeks and encourages interested persons to provide comments on the proposed rule change.

Pursuant to Section 19(b)(2)(B) of the Exchange Act,<sup>26</sup> the Commission is providing notice of the grounds for disapproval under consideration. The Commission is instituting proceedings to allow for additional analysis of the proposal's consistency with Section 6(b)(5) of the Exchange Act, which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and to protect investors and the public interest.<sup>27</sup> In light of the portfolio's potential exposure to the permitted investments identified above (including junior loans, ABS, MBS, and interests in investment pools in particular), the Commission seeks commenters' views on the sufficiency of the information provided in the proposed rule change to support a determination that the listing and trading of the Shares would be consistent with Section 6(b)(5) of the Exchange Act as modified by Amendment No. 1. The Commission notes that the Exchange proposes to exempt equity interests in investment pools from all of the requirements of Commentary .01(a)(1) to NYSE Arca Rule 8.600–E. In light of the portfolio's potential exposure to the permitted investments identified above, the Commission seeks commenters' views on the sufficiency of the information provided in the proposed rule change to support a determination that the listing and trading of the Shares would be consistent with Section 6(b)(5) of the Exchange Act as modified by Amendment No. 1.

#### IV. Procedure: Request for Written Comments

Interested persons are invited to submit written views, data, and arguments concerning the foregoing, including whether the proposed rule change as modified by Amendment No. 1 is consistent with Section 6(b)(5) or any other provision of the Exchange Act, or the rules and regulations thereunder. Although there do not appear to be any issues relevant to approval or disapproval that would be facilitated by an oral presentation of views, data, and arguments, the Commission will consider, pursuant to Rule 19b–4 under the Exchange Act,<sup>28</sup>

any request for an opportunity to make an oral presentation.<sup>29</sup>

Interested persons are invited to submit written data, views, and arguments regarding whether the proposal should be approved or disapproved by August 23, 2018. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal by September 6, 2018.

Comments may be submitted by any of the following methods:

#### Electronic Comments

- Use the Commission's internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR–NYSEArca–2018–25 on the subject line.

#### Paper Comments

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

All submissions should refer to File Number SR–NYSEArca–2018–25. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street NE, Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit

personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR–NYSEArca–2018–25 and should be submitted on or before August 23, 2018. Rebuttal comments should be submitted by September 6, 2018.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>30</sup>

**Robert W. Errett,**  
Deputy Secretary.

[FR Doc. 2018–16536 Filed 8–1–18; 8:45 am]

BILLING CODE 8011–01–P

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–83725; File No. SR–OCC–2017–020]

### Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of Amendments No. 1 and 2 to Proposed Rule Change Concerning Enhanced and New Tools for Recovery Scenarios

July 27, 2018.

On December 18, 2017, The Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission (“Commission”) proposed rule change SR–OCC–2017–020 (“Proposed Rule Change”) pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> and Rule 19b–4 thereunder,<sup>2</sup> concerning enhanced and new tools for recovery scenarios.<sup>3</sup> The Proposed Rule Change was published for comment in the **Federal Register** on December 26, 2017.<sup>4</sup> On March 22, 2018, the Commission instituted proceedings under Section 19(b)(2)(B)(i) of the Act<sup>5</sup> to determine whether to approve or

<sup>30</sup> 17 CFR 200.30–3(a)(57).

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

<sup>2</sup> 17 CFR 240.19b–4.

<sup>3</sup> On December 8, 2017, OCC also filed this proposal as an advance notice SR–OCC–2017–809 (“Advance Notice”) with the Commission pursuant to Section 806(e)(1) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, entitled the Payment, Clearing, and Settlement Supervision Act of 2010 (12 U.S.C. 5465(e)(1)) and Rule 19b–4(n)(1)(i) of the Act (17 CFR 240.19b–4(n)(1)(i)). Notice of filing of the Advance Notice was published for comment in the **Federal Register** on January 23, 2018. Securities Exchange Act Release No. 82513 (Jan. 17, 2018), 83 FR 3244 (Jan. 23, 2018) (SR–OCC–2017–809).

<sup>4</sup> Securities Exchange Act Release No. 82531 (Dec. 19, 2017), 82 FR 61107 (Dec. 26, 2017) (SR–OCC–2017–020) (“Initial Filing”).

<sup>5</sup> 15 U.S.C. 78s(b)(2)(B)(i).

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

<sup>26</sup> *Id.*

<sup>27</sup> 15 U.S.C. 78f(b)(5).

<sup>28</sup> 17 CFR 240.19b–4.

disapprove the Proposed Rule Change.<sup>6</sup> On June 20, 2018 the Commission designated a longer period for Commission action on proceedings to determine whether to approve or disapprove the Proposed Rule Change.<sup>7</sup> On July 11, 2018, OCC filed Amendment No. 1 to the Proposed Rule Change. On July 12, 2018, OCC filed Amendment No. 2 to the Proposed Rule Change to supersede and replace Amendment No. 1 in its entirety, due to technical defects in Amendment No. 1. Therefore, the Initial Filing, as modified by Amendment No. 2, reflects the changes proposed.

Pursuant to Section 19(b)(1) of the Act<sup>8</sup> and Rule 19b-4 thereunder<sup>9</sup> the Commission is publishing notice of these Amendments No. 1 and 2 to the Proposed Rule Change as described in Items I, II and III below, which Items have been prepared by OCC. The Commission is publishing this notice to solicit comments on the Proposed Rule Change, as modified by Amendments No. 1 and 2, from interested persons.

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

This proposed rule change by the OCC would make certain revisions to OCC's Rules and By-Laws to enhance OCC's existing tools to address the risks of liquidity shortfalls and credit losses and to establish new tools by which OCC could re-establish a matched book following a default. Each of the tools proposed herein is contemplated to be deployed by OCC in an extreme stress event that has placed OCC into a recovery or orderly wind-down scenario.

### **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.

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

#### **1. Purpose**

#### **Background**

The purpose of this proposed rule change is to make certain revisions to OCC's Rules and By-Laws Laws that are designed to enhance OCC's existing tools to address the risks of liquidity shortfalls and credit losses and to establish tools by which OCC could re-establish a matched book following a default. Each of the tools proposed herein is contemplated to be deployed by OCC in an extreme stress event that has placed OCC into a recovery or orderly wind-down scenario. Each of the proposed revisions also is designed to further OCC's compliance, in whole or in part, with the provisions of the Commission's rules identified immediately below.

On September 28, 2016, the Commission adopted amendments to Rule 17Ad-22<sup>10</sup> and added new Rules 17Ad-22(e)(3)(ii), (e)(4)(viii), (e)(4)(ix), (e)(7)(ix), (e)(13), (e)(23)(i) and (e)(23)(ii)<sup>11</sup> pursuant to Section 17A of the Securities Exchange Act of 1934<sup>12</sup> and the Payment, Clearing, and Settlement Supervision Act of 2010 ("Payment, Clearing and Settlement Supervision Act").<sup>13</sup> In relevant part, these new rules collectively require a covered clearing agency ("CCA"), as defined by Rule 17Ad-22(a)(5),<sup>14</sup> to establish, implement, maintain and enforce written policies and procedures reasonably designed to: (1) Maintain a risk management framework including plans for recovery and orderly wind-down necessitated by credit losses, liquidity shortfalls, general business risk losses or any other losses, (2) effectively identify, measure, monitor and manage its credit exposures to participants and those arising from its payment, clearing and settlement processes, including by addressing the allocation of credit losses a CCA might face if its collateral and other resources are insufficient to fully cover its credit exposures, (3) effectively identify, measure, monitor and manage credit exposures, including by describing the process to replenish any financial resource that a CCA may use following a default event or other event in which use of such resource is contemplated, (4) effectively identify, measure, monitor and manage liquidity

risks that arises or is borne by the CCA by, at a minimum, describing the process for replenishing any liquid resource that a CCA may employ during a stress event, (5) ensure it has the authority and operational capacity to take timely action to contain losses and liquidity demands and continue to meet its obligations, (6) publicly disclose relevant rules and material procedures, including key aspects of its default rules and procedures, and (7) provide sufficient information to enable participants to identify and evaluate the risks, fees, and other material costs they incur by participating in the CCA. The relevant portions of each of these new requirements is restated below:

- Rule 17Ad-22(e)(3)(ii) requires that each CCA "establish, implement, maintain and enforce written policies and procedures reasonably designed to . . . [m]aintain a sound risk management framework for comprehensively managing legal, credit, liquidity, operational, general business, investment, custody, and other risks that arise in or are borne by the [CCA], which . . . [i]ncludes plans for the recovery and orderly wind-down of the [CCA] necessitated by credit losses, liquidity shortfalls, losses from general business risk, or any other losses."<sup>15</sup>

- Rule 17Ad-22(e)(4)(viii) requires that each CCA "establish, implement, maintain and enforce written policies and procedures reasonably designed to . . . [e]ffectively identify, measure, monitor, and manage its credit exposures to participants and those arising from its payment, clearing, and settlement processes, including by . . . [a]ddressing allocation of credit losses the [CCA] may face if its collateral and other resources are insufficient to fully cover its credit exposures, including the repayment of any funds the [CCA] may borrow from liquidity providers."<sup>16</sup>

- Rule 17Ad-22(e)(4)(ix) requires that each CCA "establish, implement, maintain and enforce written policies and procedures reasonably designed to . . . [e]ffectively identify, measure, monitor, and manage its credit exposures to participants and those arising from its payment, clearing, and settlement processes, including by . . . [d]escribing the [CCA's] process to replenish any financial resources it may use following a default or other event in which use of such resources is contemplated."<sup>17</sup>

- Rule 17Ad-22(e)(7)(ix) requires that each CCA "establish, implement, maintain and enforce written policies

<sup>6</sup> See Securities Exchange Act Release No. 82926 (Mar. 22, 2018), 83 FR 13171 (Mar. 27, 2018) (SR-OCC-2018-020).

<sup>7</sup> See Securities Exchange Act Release No. 83484 (Jun. 20, 2018), 83 FR 29846 (Jun. 26, 2018) (SR-OCC-2017-020).

<sup>8</sup> 15 U.S.C. 78s(b)(1).

<sup>9</sup> 17 CFR 240.19b-4.

<sup>10</sup> 17 CFR 240.17Ad-22.

<sup>11</sup> 17 CFR 240.17Ad-22(e)(3)(ii), (e)(4)(viii), (e)(4)(ix), (e)(7)(ix), (e)(13), (e)(23)(i) and (e)(23)(ii).

<sup>12</sup> 15 U.S.C. 78q-1.

<sup>13</sup> 12 U.S.C. 5461 et seq.

<sup>14</sup> 17 CFR 240.17Ad-22(a)(5).

<sup>15</sup> 17 CFR 240.17Ad-22(e)(3)(ii).

<sup>16</sup> 17 CFR 240.17Ad-22(e)(v)(viii).

<sup>17</sup> 17 CFR 240.17Ad-22(e)(4)(ix).

and procedures reasonably designed to . . . [e]ffectively 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 by, at a minimum, doing the following . . . [d]escribing the [CCA's] process to replenish any liquid resources that the clearing agency may employ during a stress event.”<sup>18</sup>

- Rule 17Ad-22(e)(13) requires that each CCA “establish, implement, maintain and enforce written policies and procedures reasonably designed to . . . [e]nsure the covered clearing agency has the authority and operational capacity to take timely action to contain losses and liquidity demands and continue to meet its obligations. . . .”<sup>19</sup>

- Rule 17Ad-22(e)(23)(i) requires that each CCA “establish, implement, maintain and enforce written policies and procedures reasonably designed to . . . [p]ublicly disclose all relevant rules and material procedures, including key aspects of its default rules and procedures.”<sup>20</sup>

- Rule 17Ad-22(e)(23)(ii) requires that each CCA “establish, implement, maintain and enforce written policies and procedures reasonably designed to . . . [p]rovide sufficient information to enable participants to identify and evaluate the risks, fees, and other material costs they incur by participating in the covered clearing agency.”<sup>21</sup>

OCC meets the definition of a CCA and is therefore subject to the requirements of the CCA rules, including new Rules 17Ad-22(e)(3)(ii), (e)(4)(viii), (e)(4)(ix), (e)(7)(ix), (e)(13), (e)(23)(i) and (e)(23)(ii).<sup>22</sup>

## Proposed Changes

### Summary of Proposed Changes

In order to enhance OCC's existing tools to address the risks of liquidity shortfalls and credit losses and to establish new tools by which OCC could re-establish a matched book following a default, OCC is proposing to make the following revisions to its Rules and By-Laws:

(1) Revise the existing assessment powers in Section 6 of Article VIII of OCC's By-Laws, specifically to:

(a) Establish a rolling “cooling-off period” that would be triggered by the

payment of a proportionate charge against the Clearing Fund (“triggering proportionate charge”), during which period the aggregate liability of a Clearing Member to replenish the Clearing Fund (inclusive of assessments) would be 200% of the Clearing Member's required contribution as of the time immediately preceding the triggering proportionate charge;

(b) Clarify that a Clearing Member that chooses to terminate its membership status during a cooling-off period will not be liable for replenishment of the Clearing Fund immediately following the expiration of such cooling-off period, provided that the withdrawing Clearing Member satisfies enumerated criteria, including providing notice of such termination by no later than the end of the cooling-off period and by closing-out and/or transferring of all its open positions with OCC by no later than the last day of the cooling-off period; and

(c) Delineate between the obligation of a Clearing Member to replenish its contributions to the Clearing Fund and its obligations to meet additional “assessments” that may be levied following a proportionate charge to the Clearing Fund.

(2) Adopt a new Rule 1011<sup>23</sup> that would provide OCC with discretionary authority to call for voluntary payments from non-defaulting Clearing Members in a circumstance where one or more Clearing Members has already defaulted and OCC has determined that it may not have sufficient resources to satisfy its obligations and liabilities resulting from such default.<sup>24</sup> Rule 1011 also would establish that OCC would prioritize compensation of Clearing Members that made voluntary payments from any

amounts recovered from the defaulted Clearing Members.

(3) Adopt a new Rule 1111 that would provide authority to:

(a) Allow OCC to call for voluntary tear-ups (“Voluntary Tear-Up,” as defined below) of non-defaulting Clearing Member and/or customer positions at any time following the suspension or default of a Clearing Member, with the scope of any such Voluntary Tear-Ups being determined by the Risk Committee of OCC's Board (“Risk Committee”);

(b) Allow OCC's Board to vote to tear-up the “Remaining Open Positions” (defined below) of a defaulted Clearing Member, as well as any “Related Open Positions” (defined below) in a circumstance where OCC has attempted one or more auctions of such defaulted Clearing Member's remaining open positions and OCC has determined that it may not have sufficient resources to satisfy its obligations and liabilities resulting from such default with the scope of any such tear-up (“Partial Tear-Up”) being determined by the Risk Committee; and

(c) Allow OCC's Board to vote to re-allocate losses, costs and fees imposed upon holders of positions extinguished in a Partial Tear-Up through a special charge levied against remaining non-defaulting Clearing Members.

(4) Revise the descriptions and authorizations in Article VIII of OCC's By-Laws concerning the use of the Clearing Fund to reflect the discretion of OCC to use remaining Clearing Fund contributions to re-allocate losses imposed on non-defaulting Clearing Members and customers from a Voluntary Tear-Up or a mandatory tear-up (“Partial Tear-Up,” as defined below).

### Discussion of Proposed Changes

Each of the proposed revisions to OCC's Rules and By-Laws is described in more detail in the following subsections:

#### 1. Proposed Changes to OCC's Assessment Powers

##### a. Current Assessment Powers

OCC's current assessment powers are described in Section 6 of Article VIII of OCC's By-Laws. Section 6 establishes a general requirement for each Clearing Member to promptly make good any deficiency in its required contribution to the Clearing Fund whenever an amount is paid out of its Clearing Fund contribution (whether by proportionate

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

<sup>19</sup> 17 CFR 240.17Ad-22(e)(13).

<sup>20</sup> 17 CFR 240.17Ad-22(e)(23)(i).

<sup>21</sup> 17 CFR 240.17Ad-22(e)(23)(ii).

<sup>22</sup> 17 CFR 240.17Ad-22(e)(3)(ii), (e)(4)(viii), (e)(4)(ix) and (e)(7)(ix).

<sup>23</sup> OCC is amending the Initial Filing to renumber proposed Rule 1009 to proposed Rule 1011 and updated related cross references in Rule 1111 to reflect this renumbering. OCC is also amending the Default Management Policy as submitted in the Initial Filing to update similar cross references.

<sup>24</sup> Under the Initial Filing, OCC's authority to conduct Partial Tear-Ups, as well as call for voluntary payments or to conduct Voluntary Tear-Ups, would be conditioned in part on OCC having determined that, notwithstanding the availability of any remaining resources, OCC may not have sufficient resources to satisfy its obligations and liabilities resulting from such default. Under the Initial Filing, the proposed text of Rules 1009(a), 1111(a) and 1111(b) incorrectly transcribed this condition to require that OCC determine that, notwithstanding the availability of any remaining resources, OCC *does* not have sufficient resources to satisfy its obligations and liabilities resulting from such default (emphasis added). In each such instance, OCC is amending the proposed text of Rules 1009(a) (which is being renumbered as Rule 1011(a)), 1111(a) and 1111(b) in Exhibit 5B of the Initial Filing to delete the word “does” and insert in its place the word “may.”

charge or otherwise).<sup>25</sup> In this regard, a Clearing Member's obligation to replenish the Clearing Fund is not currently subject to any pre-determined limit. Notwithstanding the foregoing, a Clearing Member can limit the amount of its liability for replenishing the Clearing Fund (at an additional 100% of the amount of its then-required Clearing Fund contribution) by winding-down its clearing activities and terminating its status as a Clearing Member. Any Clearing Member seeking to so limit its liability for replenishing the Clearing Fund must: (i) notify OCC in writing not later than the fifth business day after the proportionate charge that it is terminating its status as a Clearing Member, (ii) not initiate any opening purchase or opening writing transaction, and, if the Clearing Member is a Market Loan Clearing Member or a Hedge Clearing Member, not initiate any Stock Loan transaction, through any of its accounts, and (iii) close out or transfer all of its open positions as promptly as practicable after giving notice to OCC. Thus, withdrawal from clearing membership is the only means by which a Clearing Member currently can limit its liability for replenishing the Clearing Fund.

#### b. Proposed Changes to Assessment Powers

OCC proposes to revise Section 6 of Article VIII of OCC's By-Laws to make three primary modifications regarding its existing authority to assess proportionate charges against Clearing Members' contributions to the Clearing Fund. First, the proposal introduces an automatic minimum fifteen calendar day "cooling-off" period that begins when a proportionate charge is assessed by OCC against Clearing Members'

Clearing Fund contributions. While the cooling-off period will continue for a minimum of fifteen consecutive calendar days, if one or more of the events described in clauses (i) through (iv) of Article VIII, Section 5(a) of OCC's By-Laws occur(s) during that fifteen calendar day period and result in one or more proportionate charges against the Clearing Fund, the cooling-off period shall be extended through either (i) the fifteenth calendar day from the date of the most recent proportionate charge resulting from the subsequent event, or (ii) the twentieth day from the date of the proportionate charge that initiated the cooling-off period, whichever is sooner.

During a cooling-off period, each Clearing Member would have its aggregate liability to replenish the Clearing Fund capped at 200% of the Clearing Member's then-required contribution to the Clearing Fund. Once the cooling-off period ends each remaining Clearing Member would be required to replenish the Clearing Fund in the amount necessary to meet its then-required contribution. Once the cooling-off period ends, any remaining losses or expenses suffered by OCC as a result of any event described in clauses (i) through (iv) of Article VIII, Section 5(a) of OCC's By-Laws that occurred during such cooling-off period could not be charged against the amounts Clearing Members have contributed to replenish the Clearing Fund upon the expiration of the cooling-off period.<sup>26</sup>

Second, in connection with the cooling-off period, the proposal would extend the time frame within which a Clearing Member may provide a termination notice to OCC to avoid liability for replenishment of the Clearing Fund after the cooling-off period and would modify the obligations of such a terminating Clearing Member for closing-out and transferring its remaining open positions. Specifically, to effectively terminate its status as a Clearing Member and not be liable for replenishing the Clearing Fund after the cooling-off period, a Clearing Member would be required to: (i) notify OCC in writing of its intent to terminate not later than the last day of the cooling-off period, (ii) not initiate any opening purchase or opening writing transaction,

and, if the Clearing Member is a Market Loan Clearing Member or a Hedge Clearing Member, not initiate any Stock Loan transaction, through any of its accounts, and (iii) close-out or transfer all of its open positions by no later than the last day of the cooling-off period. If a Clearing Member fails to satisfy all of these conditions by the end of a given cooling-off period, it would not have completed all of the requirements necessary to terminate its status as a Clearing Member under Article VIII, Section 6 of OCC's By-Laws and therefore it would remain subject to the obligation to replenish the Clearing Fund after the end of the cooling-off period.

Third, the proposal would clarify the distinction between "replenishment" of the Clearing Fund and a Clearing Member's obligation to answer "assessments." In this context, the term "replenish" (and its variations) shall to refer to a Clearing Member's standing duty, following any proportionate charge against the Clearing Fund, to return its Clearing Fund contribution to the amount required from such Clearing Member for the month in question.<sup>27</sup> The term "assessment" (and its variations) shall refer to the amount, during any cooling-off period, that a Clearing Member would be required to contribute to the Clearing Fund in excess of the amount of the Clearing Member's pre-funded required Clearing Fund contribution.

#### Proposed Addition of Ability To Request Voluntary Payments

OCC proposes to add new Rule 1011, which will provide a framework by which OCC could receive voluntary payments in a circumstance where a Clearing Member has defaulted and OCC has determined that, notwithstanding the availability of any remaining resources under OCC Rules 707, 1001, 1104 through 1107, 2210 and 2211,<sup>28</sup> OCC may not have sufficient resources to satisfy its obligations and liabilities resulting from such default. Under new Rule 1011, OCC will initiate a call for voluntary payments by issuing

<sup>25</sup> Under Article VIII, Section 6 of OCC's By-Laws, OCC currently has authority to assess proportionate charges against Clearing Members' contributions to the Clearing Fund in certain enumerated situations. For example, Section 6 generally provides that if the conditions regarding a Clearing Member default specified in subparagraphs (a)(i) through (vi) of Article VIII, Section 5 of OCC's By-Laws are satisfied, OCC will make good resulting losses or expenses that are suffered by OCC by applying the defaulting Clearing Member's Clearing Fund contribution after first applying other funds available to OCC in the accounts of the Clearing Member. If the sum of the obligations, however, exceeds the total Clearing Fund contribution and other funds of the defaulting Clearing Member available to OCC, then OCC will charge the amount of the remaining deficiency on a proportionate basis against all non-defaulting Clearing Members' required contributions to the Clearing Fund at the time. Section 5(b) of Article VIII of OCC's By-Laws similarly provides for proportionate charges against Clearing Members' contributions to the Clearing Fund when certain conditions are met that involve a failure by a bank or a securities or commodities clearing organization to perform obligations to OCC when they are due.

<sup>26</sup> After a cooling-off period has ended, the occurrence of any event described in clauses (i) through (iv) of Article VIII, Section 5(a) of OCC's By-Laws that results in a proportionate charge against the Clearing Fund would trigger a new cooling off period, and thusly, a cap of 200% of each Clearing Member's then-required contribution would again apply.

<sup>27</sup> This assumes that the proportionate charge resulted in the Clearing Member's actual Clearing Fund contribution dropping below the amount of its required contribution (*i.e.*, that the Clearing Member did not have excess above its required contribution that was sufficient to cover the amount of the proportionate charge allocated to such Clearing Member).

<sup>28</sup> Rule 707 addresses the treatment of funds in a Clearing Member's X-M accounts. Rule 1001 addresses the size of OCC's Clearing Fund and the amount of a Clearing Member's contribution. Rules 1104 through 1107 concern the treatment of the portfolio of a defaulted Clearing Member. Rules 2210 and 2211 concern the treatment of Stock Loan positions of a defaulted Clearing Member.

a “Voluntary Payment Notice” inviting all non-defaulting Clearing Members to make payments to the Clearing Fund in addition to any amounts they are otherwise required to contribute pursuant to Rule 1001. The Voluntary Payment Notice would specify the terms applicable to any voluntary payment, including but not limited to, that any voluntary payment may not be withdrawn once made, that no Clearing Member shall be obligated to make a voluntary payment and that OCC shall retain full discretion to accept or reject any voluntary payment. Rule 1011 specifies that if OCC subsequently recovers from the defaulted Clearing Member or the estate(s) of the defaulted Clearing Member(s), OCC would seek to compensate first from such recovery all non-defaulting Clearing Members that made voluntary payments (and if the amount recovered from the defaulted Clearing Member(s) is less than the aggregate amount of voluntary payments, non-defaulting Clearing Members that made voluntary payments each would receive a percentage of the recovery that corresponds to that Clearing Member’s percentage of the total amount of voluntary payments received).

#### Proposed Addition of Ability To Conduct Voluntary Tear-Ups

OCC proposes to add new Rule 1111, which, in relevant part, will establish a framework by which non-defaulting Clearing Members and non-defaulting customers of Clearing Members could be given an opportunity to voluntarily extinguish (*i.e.*, voluntarily tear-up) their open positions at OCC in a circumstance where a Clearing Member has defaulted and OCC has determined that, notwithstanding the availability of any remaining resources under OCC Rules 707, 1001, 1104 through 1107, 2210 and 2211, OCC may not have sufficient resources to satisfy its obligations and liabilities resulting from such default.

While Risk Committee approval is not needed to commence a voluntary tear-up, the Risk Committee would be responsible for determining the appropriate scope of each voluntary tear-up. To ensure OCC retains sufficient flexibility to effectively deploy this tool in an extreme stress event, proposed Rule 1111(c) is drafted to provide the Risk Committee with discretion to determine the appropriate scope of each voluntary tear-up.<sup>29</sup> New

Rule 1111(c) also would impose standards designed to circumscribe the Risk Committee’s discretion, requiring that any determination regarding the scope of a voluntary tear-up shall (i) be based on then-existing facts and circumstances, (ii) be in furtherance of the integrity of OCC and the stability of the financial system, and (iii) take into consideration the legitimate interests of Clearing Members and market participants.

Once the Risk Committee has determined the scope of the Voluntary Tear-Up, OCC will initiate the call for voluntary tear-ups by issuing a “Voluntary Tear-Up Notice.” The Voluntary Tear-Up Notice shall inform all non-defaulting Clearing Members of the opportunity to participate in a Voluntary Tear-Up.<sup>30</sup> The Voluntary Tear-Up Notice would specify the terms applicable to any voluntary tear-up, including but not limited to, that no Clearing Member or customers of a Clearing Member shall be obligated to participate in a voluntary tear-up and that OCC shall retain full discretion to accept or reject any voluntary tear-up.

OCC is not proposing a tear-up process that would require the imposition of “gains haircutting” (*i.e.*, the reduction of unpaid gains) on a portion of OCC’s cleared contracts.<sup>31</sup> Instead, OCC has determined that its tear-up process—for both Voluntary Tear-Ups as well as Partial Tear-Ups—should be initiated on a date sufficiently in advance of the exhaustion of OCC’s financial resources such that OCC would be expected to have adequate remaining resources to cover the amount it must pay to extinguish the positions of Clearing Members and customers without haircutting gains.<sup>32</sup>

In OCC’s proposed tear-up process, the holders of torn-up positions would

remaining in the portfolio(s) of the defaulted Clearing Member(s).

<sup>30</sup> Since OCC does not know the identities of Clearing Members’ customers, OCC would depend on each Clearing Member to notify its customers with positions in scope of the Voluntary Tear-Up of the opportunity to participate in such tear-up.

<sup>31</sup> In general, forced gains haircutting is a tool that can be more easily applied to products whose gains are settled at least daily, like futures through an exchange of variation margin, and by central counterparties with comparatively large daily settlement flows. Listed options, which constitute the vast majority of the contracts cleared by OCC, do not have daily settlement flows and any attempt to reduce the “unrealized gains” of a listed options contract would require the reduction of the option premium that is embedded within the required margin (such a process would effectively require haircutting the listed option’s initial margin).

<sup>32</sup> OCC anticipates that it would determine the date on which to initiate Partial Tear-Ups by monitoring its remaining financial resources against the potential exposure of the remaining unauctioned positions from the portfolio(s) of the defaulted Clearing Member(s).

be assigned a Tear-Up Price and OCC would draw on its remaining financial resources in order to extinguish the torn-up positions at the assigned Tear-Up Price without forcing a reduction in the amount of unpaid value of such positions. OCC is amending the Initial Filing to clarify that while OCC does not intend, in the first instance, for its tear-up process to serve as a means of loss allocation, circumstances may arise such that, despite best efforts, OCC has inadequate remaining financial resources to extinguish torn-up positions at their assigned Tear-Up Price without forcing a reduction in the amount of unpaid value of such positions (*e.g.*, despite best efforts, market movements not accounted for by monitoring, additional Clearing Member defaults occur immediately preceding a tear-up). In such circumstances, despite best efforts, OCC would use its partial tear-up process as a means of loss allocation.<sup>33</sup>

The proposed changes would provide OCC with two separate and non-exclusive means of equitably re-allocating the losses, costs or expenses imposed upon the holders of torn-up positions as a result of the tear-up(s). First, the proposed changes to Article VIII would provide OCC discretion to use remaining Clearing Fund contributions to re-allocate losses imposed on non-defaulting Clearing Members and customers from such tear-up(s). Second, Rule 1111(a) would provide that if OCC subsequently recovers from the defaulted Clearing Member or the estate(s) of the defaulted Clearing Member(s) and the amount of such recovery exceeds the amount OCC received in voluntary payments, then non-defaulting Clearing Members and non-defaulting customers that voluntarily tore-up open positions and incurred losses from such tear-ups would be repaid from the amount of the recovery in excess of the amount OCC received in voluntary payments.<sup>34</sup> If the amount recovered is less than the aggregate amount of Voluntary Tear-Up,

<sup>33</sup> This change does not impact the statutory basis for the proposed rule change.

<sup>34</sup> In order to effect re-allocation of the losses, costs or expenses imposed upon the holders of torn-up positions, OCC expects that after it has completed its tear-up process and re-established a matched book, holders of both voluntarily torn-up and mandatorily torn-up positions would be provided with a limited opportunity to re-establish positions in the contracts that were voluntarily or mandatorily extinguished. After the expiration of such period, OCC would seek to collect the information on the losses, costs or expenses that had been imposed on the holders of torn-up positions. Based on the information collected, OCC would determine whether it can reasonably determine the losses, costs and expenses sufficiently to re-allocate such amounts.

<sup>29</sup> Notwithstanding the discretion that would be afforded by the text of proposed Rule 1111(c), OCC anticipates that the scope of voluntary tear-ups likely would be dictated by the cleared contracts

each non-defaulting Clearing Member and non-defaulting customer that incurred losses from voluntarily torn-up positions would be repaid in an amount proportionate to the percentage of its total amount of losses, costs and fees imposed on Clearing Members or customers as a result of the Voluntary Tear-Ups.

With respect to Voluntary Tear-Ups, new Rule 1111(h) would clarify that no action or omission by OCC pursuant to and in accordance Rule 1111 shall constitute a default by OCC.

#### Proposed Addition of Ability To Conduct Partial Tear-Ups

OCC proposes to add new Rule 1111, which, in relevant part, will provide the Board with discretion to extinguish the remaining open positions of any defaulted Clearing Member or customer of such defaulted Clearing Member(s) (such positions, “Remaining Open Positions”), as well as any related open positions as necessary to mitigate further disruptions to the markets affected by the Remaining Open Positions (such positions, “Related Open Positions”), in a circumstance where a Clearing Member has defaulted and OCC has determined that, notwithstanding the availability of any remaining resources under OCC Rules 707, 1001, 1104 through 1107, 2210 and 2211, OCC may not have sufficient resources to satisfy its obligations and liabilities resulting from such default (such tear-ups hereinafter collectively referred to as “Partial Tear-Ups”). Like the determination for Voluntary Tear-Ups, the Risk Committee shall determine the appropriate scope of each Partial Tear-Up and such determination shall (i) be based on then-existing facts and circumstances, (ii) be in furtherance of the integrity of OCC and the stability of the financial system, and (iii) take into consideration the legitimate interests of Clearing Members and market participants. Once the Risk Committee has determined the scope of the Partial Tear-Up, OCC will initiate the Partial Tear-Up process by issuing a “Partial Tear-Up Notice.” The Partial Tear-Up Notice shall (i) identify the Remaining Open Positions and Related Open Positions designated for tear-up, (ii) identify the open positions of non-defaulting Clearing Members and non-defaulting customers that will be subject to Partial Tear-Up (such positions, “Tear-Up Positions”), (iii) specify the termination price (“Partial Tear-Up Price”) for each position to be torn-up, and (iv) list the date and time as of

which the Partial Tear-Up will occur.<sup>35</sup> With regard to the date and time of a Partial Tear-Up, Rule 1111(d) specifies that the Risk Committee shall set the date and time. With regard to the Partial Tear-Up Price, OCC anticipates that it is likely to use the last established end-of-day settlement price, in accordance with its existing practices concerning pricing and valuation. However, given that it is not possible to know in advance the precise circumstances that would cause OCC to conduct a tear-up, Rule 1111(f) has been drafted to allow OCC to exercise reasonable discretion, if necessary, in establishing the Partial Tear-Up Price by some means other than its existing practices concerning pricing and valuation.<sup>36</sup> Specifically, Rule 1111(f) would require that OCC, in exercising any such discretion, would act in good faith and in a commercially reasonable manner to adopt methods of valuation expected to produce reasonably accurate substitutes for the values that would have been obtained from the relevant market if it were operating normally, including but not limited to the use of pricing models that use the market price of the underlying interest or the market prices of its components. Rule 1111(f) further specifies that OCC may consider the same information set forth in subpart (c) of Section 27, Article VI of OCC’s By-Laws.<sup>37</sup>

<sup>35</sup> Since OCC does not know the identities of Clearing Members’ customers, OCC would depend on each Clearing Member to notify its customers with positions in scope of the Partial Tear-Up of the possibility of tear-up.

<sup>36</sup> For example, OCC has observed certain rare circumstances in which a closing price for an underlying security of an option may be stale or unavailable. A stale or unavailable closing price could be the result of a halt on trading in the underlying security, or a corporate action resulting in a cash-out or conversion of the underlying security (but that has not yet been finalized), or the result of an ADR whose underlying security is being impacted by certain provisions under foreign laws. OCC would consider the presence of these factors on its end-of-day prices in determining whether use of the discretion that would be afforded under proposed Rule 1111(f) might be warranted.

<sup>37</sup> In relevant part, subpart (c) reads as follows: “In determining a close-out amount, the Corporation may consider any information that it deems relevant, including, but not limited to, any of the following: (1) Prices for underlying interests in recent transactions, as reported by the market or markets for such interests; (2) quotations from leading dealers in the underlying interest, setting forth the price (which may be a dealing price or an indicative price) that the quoting dealer would charge or pay for a specified quantity of the underlying interest; (3) relevant historical and current market data for the relevant market, provided by reputable outside sources or generated internally; and (4) values derived from theoretical pricing models using available prices for the underlying interest or a related interest and other relevant data. Amounts stated in a currency other than U.S. Dollars shall be converted to U.S. Dollars at the current rate of exchange, as determined by

The scope of any Partial Tear-Up will be determined in accordance with Rule 1111(e).<sup>38</sup> With respect to the extinguishment of Remaining Open Positions, OCC will designate Tear-Up Positions in identical Cleared Contracts and Cleared Securities on the opposite side of the market and in an aggregate amount equal to that of the Remaining Open Positions. OCC will only designate Tear-Up Positions in the accounts of non-defaulting Clearing Members (inclusive of such Clearing Members’ customer accounts) with an open position in the applicable Cleared Contract or Cleared Security.<sup>39</sup> Tear-Up Positions shall be designated and applied by OCC on a pro rata basis across all the identical positions in Cleared Contracts and Cleared Securities on the opposite side of the market in the accounts of non-defaulted Clearing Members and their customers.<sup>40</sup>

Rule 1111(e)(iii) provides that every Partial Tear-Up position is automatically terminated upon and with effect from the Partial Tear-Up Time, without the need for any further step by any party to such Cleared Contract or Cleared Security, and that upon termination, either OCC or the relevant Clearing Member (as the case may be) shall be obligated to pay the other the applicable Partial Tear-Up Price. Rule

the Corporation. A position having a positive close-out value shall be an ‘asset position’ and a position having a negative close-out value shall be a ‘liability position.’”

<sup>38</sup> OCC is amending the Initial Filing to reflect that after further evaluation of its proposed recovery tools and the proposed tear-up process, OCC does not believe there would be a need to assign or transfer any hedging transactions established with relation to tear-up positions. OCC is therefore amending the Initial Filing to remove text in proposed Rule 1111(e) concerning proposed authority for OCC to offer to assign or transfer any hedging transactions related to Remaining Open Positions with related Tear-Up Positions. This change does not impact the statutory basis for the proposed rule change.

<sup>39</sup> Since, as stated in the Initial Filing, the objective of Partial Tear-Ups is to extinguish the Remaining Open Positions cleared by the defaulted Clearing Member(s) or customer of such defaulted Clearing Member(s) (emphasis added), OCC does not believe there would be a need to designate Tear-Up Positions to the non-defaulted customers of a defaulted Clearing Member. OCC is therefore amending the Initial Filing to remove references to non-defaulted customers of defaulted Clearing Members.

<sup>40</sup> OCC is amending the Initial Filing to clarify that a non-defaulted Clearing Member would be required to allocate the assigned Tear-Up Positions on a pro rata basis across those customers that have open positions in such Cleared Contract or Cleared Security in such account, and for any listed option positions being extinguished, allocation across customer accounts should occur in accordance with such Clearing Member’s procedures for allocating exercises and assignments. This change does not impact the statutory basis for the proposed rule change.

1111(e)(iii) further provides that the corresponding open position shall be deemed terminated at the Partial Tear-Up Price.<sup>41</sup>

Rule 1111(g) provides that to the extent losses imposed upon non-defaulting Clearing Members and non-defaulting customers resulting from a Partial Tear-Up can reasonably be determined, the Board may elect to re-allocate such losses among all non-defaulting Clearing Members through a special charge to all non-defaulting Clearing Members in an amount corresponding to each such non-defaulting Clearing Member's proportionate share of the variable amount of the Clearing Fund at the time such Partial Tear-Up is conducted.<sup>42</sup>

With respect to Partial Tear-Ups, new Rule 1111(h) would clarify that no action or omission by OCC pursuant to and in accordance Rule 1111 shall constitute a default by OCC.

## 2. Statutory Basis

Section 17A(b)(3)(F) of the Securities Exchange Act of 1934 ("Act"),<sup>43</sup> requires, among other things, that the rules of a clearing agency be designed to foster cooperation and coordination with persons engaged in the clearance and settlement of securities transactions, to remove impediments to and perfect the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions, and, in general, to protect investors and the public interest. OCC believes that the proposed rule change is consistent with the requirements of Section 17A(b)(3)(F) of the Act<sup>44</sup> and the rules thereunder applicable to OCC for the reasons set forth below.

As stated above, each of the changes is designed to provide OCC with tools to address the risks OCC might confront

in a recovery and orderly wind-down scenario. In this regard, the proposed changes are designed to further address the risks of liquidity shortfalls and credit losses resulting from a Clearing Member default or certain other loss events and to establish tools to enable OCC to re-establish a matched book and limit OCC's potential exposure to losses from a Clearing Member default, in each case as might result from an unprecedented loss scenario that exceeds OCC's standard risk management and default management procedures. OCC's process in crafting the proposed changes was informed by published guidance from OCC's primary regulators (the Commission and the Commodity Futures Trading Commission), the publications of key international organizations (including the Bank for International Settlements, the International Organization of Securities Commissions and the Financial Stability Board) and the publications of key industry trade organizations. OCC's proposal was further informed by conversations with, among others, OCC's Board, OCC's Risk Committee, Clearing Members and market participants.

Informed by these perspectives, OCC has crafted the proposed changes with the aim of enhancing its ability to address an unprecedented loss event but also, to the extent possible, providing a reasonable amount of certainty to Clearing Members, customers and other stakeholders about the potential consequences of such an event and the resources and tools that would be expected to be available to OCC in support of its clearing operations.<sup>45</sup> Accordingly, the proposed changes should leave Clearing Members, customers and other stakeholders in a position to better evaluate the risks and benefits of clearing in order to facilitate their own risk management, and to the extent applicable, their own regulatory and capital considerations. The proposed changes also seek to avoid a result that would force only particular clearing participants to shoulder certain losses in an extreme stress scenario (*i.e.*, holders of positions extinguished in Partial Tear-Ups),<sup>46</sup> and instead leaves OCC and its Board with discretionary tools that could provide a more equitable method of allocating the losses

from such an event more broadly, consistent with the general principle of mutualized loss that upon which central clearing rests. In this regard, OCC believes the proposed changes foster cooperation and coordination with participants in the clearing system, consistent with Section 17A(b)(3)(F) of the Act.<sup>47</sup>

As stated above, the proposed changes are designed to enable OCC to further address the risks of liquidity shortfalls and credit losses resulting from a Clearing Member default or certain other loss events and to re-establish a matched book and limit OCC's potential exposure to losses from a Clearing Member default, in each case as might result from an unprecedented loss scenario that exceeds OCC's standard risk management and default management procedures. OCC believes that the proposed changes will facilitate its ability to fully allocate, and ultimately extinguish, the loss so that it has a better opportunity of withstanding an extreme stress scenario without sacrificing its viability as a going concern or its ability to continue to provide its critical clearing services. In this regard, OCC believes that the proposed changes remove impediments to and perfect the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions, consistent with Section 17A(b)(3)(F) of the Act.<sup>48</sup>

The proposed changes are designed to enhance the stability of the clearing system generally and are aimed at ensuring that OCC has adequate tools and resources to better protect market participants from the risks of extreme stress scenarios and unprecedented loss events. In this regard, OCC believes that the proposed changes are reasonably designed to protect investors and the public interest, consistent with Section 17A(b)(3)(F) of the Act.<sup>49</sup>

The proposed changes also are designed to further OCC's compliance, in whole or in part, with the provisions of the Commission's rules discussed immediately below:

## Recovery and Orderly Wind-Down

In relevant part, Rule 17Ad-22(e)(3)(ii) requires that each CCA "establish, implement, maintain and enforce written policies and procedures reasonably designed to . . . plan[] for the recovery and orderly wind-down of the [CCA] necessitated by credit losses, liquidity shortfalls, losses from general

<sup>41</sup> OCC is amending the Initial Filing and the proposed text of Rule 1111(e)(iii) to clarify that if, in certain circumstances discussed above (see fn. 27 and associated text), OCC, in its discretion, determines that its remaining resources are inadequate to pay the applicable Partial Tear-Up Price for each position being extinguished in the Partial Tear-Up, OCC shall be obligated to pay each relevant Clearing Member a pro rata amount of the applicable Partial Tear-Up Price based on OCC's remaining resources, and the relevant Clearing Member shall have a claim against the Corporation for the value of the difference between the pro rata amount received and the Partial Tear-Up Price. This change does not impact the statutory basis for the proposed rule change.

<sup>42</sup> For the avoidance of doubt, the special charge would be distinct and separate from a Clearing Member's obligation to satisfy Clearing Fund assessments, and therefore, would not be subject to the aforementioned assessment cap in the amount of 200% of a Clearing Member's then-required contribution to the Clearing Fund.

<sup>43</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>44</sup> *Id.*

<sup>45</sup> OCC notes that the very nature of an extreme stress and unprecedented loss event means that its impact is difficult to predict and quantify in advance.

<sup>46</sup> Absent a means of re-allocating the potential losses, costs and fees imposed upon holders of positions extinguished during tear-ups, the holders of such positions would be left to individually address such losses, costs and fees.

<sup>47</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>48</sup> *Id.*

<sup>49</sup> *Id.*



business risk, or any other losses.”<sup>50</sup> As stated above, each of the proposed changes is designed to provide OCC with tools to address the risks OCC might confront in a recovery and orderly wind-down scenario.<sup>51</sup> Consistent with the requirements of Rule 17Ad–22(e)(3)(ii), the proposed tools would enable OCC to better address the risks of liquidity shortfalls and credit losses resulting from a Clearing Member default or certain other loss events and, if necessary, to ultimately re-establish a matched book in a recovery or orderly wind-down scenario.<sup>52</sup> In this context, the proposed changes serve as a critical component of OCC’s recovery and orderly wind-down plan. As a result, in OCC’s view, the proposed changes are consistent with the requirements of Rule 17Ad–22(e)(3)(ii) as to the recovery and orderly wind-down plan.<sup>53</sup>

#### Allocation of Credit Losses Above Available Resources

In relevant part, Rule 17Ad–22(e)(4)(viii) requires that each CCA “establish, implement, maintain and enforce written policies and procedures reasonably designed to . . . [a]ddress[ ] allocation of credit losses the [CCA] may face if its collateral and other resources are insufficient to fully cover its credit exposures . . .”<sup>54</sup> The proposed changes would provide OCC with three distinct tools that could be used to allocate any credit losses OCC may face in excess of collateral and other resources available to OCC. First, new Rule 1011 would provide a framework by which OCC could receive voluntary payments in a circumstance where a Clearing Member has defaulted and OCC has determined that, notwithstanding the availability of any remaining resources under OCC Rules 707, 1001, 1104 through 1107, 2210 and 2211,<sup>55</sup> OCC may not have sufficient

resources to satisfy its obligations and liabilities resulting from such default. Second, new Rule 1111 would establish a framework by which non-defaulting Clearing Members and non-defaulting customers of Clearing Members could be given an opportunity to participate in Voluntarily Tear-Ups in a circumstance where a Clearing Member has defaulted and OCC has determined that, notwithstanding the availability of any remaining resources under OCC Rules 707, 1001, 1104 through 1107, 2210 and 2211, OCC may not have sufficient resources to satisfy its obligations and liabilities resulting from such default. Finally, new Rule 1111 also would provide the Board with discretion to mandatorily tear-up Remaining Open Positions and Related Open Positions, in a circumstance where a Clearing Member has defaulted and OCC has determined that, notwithstanding the availability of any remaining resources under OCC Rules 707, 1001, 1104 through 1107, 2210 and 2211, OCC may not have sufficient resources to satisfy its obligations and liabilities resulting from such default.<sup>56</sup> In OCC’s view, each of these tools could be deployed by OCC, if necessary, to allocate credit losses in excess of the collateral and other resources available to OCC, in accordance with Rule 17Ad–22(e)(4)(viii).<sup>57</sup>

#### Replenishment of Financial Resources Following a Default

In relevant part, Rule 17Ad–22(e)(4)(ix) requires that each CCA “establish, implement, maintain and enforce written policies and procedures reasonably designed to . . . [d]escrib[e] the [CCA’s] process to replenish any financial resources it may use following a default or other event in which use of such resources is contemplated.”<sup>58</sup> OCC’s Clearing Members have a standing obligation to replenish the Clearing Fund following any proportionate charge. The proposed changes would establish a rolling cooling-off period, triggered by the payment of a proportionate charge against the Clearing Fund, during which period the aggregate liability of a Clearing Member to replenish the Clearing Fund (inclusive of

assessments) would be 200% of the Clearing Member’s required contribution as of the time immediately preceding the triggering proportionate charge. Compared to the current requirement under which a Clearing Member may cap its liability to proportionate charges at an additional 100% of its then-required contribution, a Clearing Member would instead be permitted to cap its liability for proportionate charges at an additional 200% of its then-required Clearing Fund contribution.

OCC believes that the proposed approach improves predictability for OCC and for Clearing Members regarding the size of Clearing Fund contributions that are likely to be subject to assessments for proportionate charges. Additionally, replacing the five business day withdrawal period with the withdrawal period commensurate with the cooling-off period (which, as proposed would be a minimum of fifteen calendar days) would give Clearing Members a more reasonable period in which to meet the wind-down and termination requirements necessary to cap their liability. OCC believes that this would afford them greater certainty regarding their maximum liability with respect to the Clearing Fund during extreme stress events, which in turn, facilitates Clearing Members’ management of their own risk management, and to the extent applicable, regulatory capital considerations. And OCC believes this increased predictability would also be beneficial to OCC by helping it to more reliably understand the amount of Clearing Fund contributions that will likely be available to it after a proportionate charge is assessed.<sup>59</sup>

OCC believes that the relative certainty provided by the proposed cooling-off period and 200% cap on assessments ultimately could reduce the risks of successive or “cascading” defaults, in which the financial demands on remaining non-defaulting Clearing Members to continually replenish OCC’s Clearing Fund (and similar guaranty funds at other CCPs to which such Clearing Members might belong) have the effect of further weakening such Clearing Members to the point of default. In this regard, the proposed changes are designed to provide OCC, Clearing Members and other stakeholders with sufficient time to manage the ongoing default(s)

<sup>50</sup> 17 CFR 240.17Ad–22(e)(3)(ii).

<sup>51</sup> Indeed, the OCC’s separately filed recovery and orderly wind-down plan identifies OCC’s assessment powers, ability to call for voluntary payments, ability to call for Voluntary Tear-Ups and ability to impose Partial Tear-Ups among its “Recovery Tools.” OCC has filed a proposed rule change with the Commission in connection with this proposal. See Securities Exchange Act Release No. 82352 (December 19, 2017), 82 FR 61072 (December 26, 2017) (SR–OCC–2017–021). On March 22, 2018, the Commission instituted proceedings to determine whether to approve or disapprove the proposed rule change. See Securities Exchange Act Release No. 82927 (March 22, 2018), 83 FR 13176 (March 27, 2018) (SR–OCC–2017–021).

<sup>52</sup> 17 CFR 240.17Ad–22(e)(3)(ii).

<sup>53</sup> 17 CFR 240.17Ad–22(e)(3)(ii).

<sup>54</sup> 17 CFR 240.17Ad–22(e)(v)(viii).

<sup>55</sup> Rule 707 addresses the treatment of funds in a Clearing Member’s X–M accounts. Rule 1001 addresses the size of OCC’s Clearing Fund and the amount of a Clearing Member’s contribution. Rules 1104 through 1107 concern the treatment of the

portfolio of a defaulted Clearing Member. Rules 2210 and 2211 concern the treatment of Stock Loan positions of a defaulted Clearing Member.

<sup>56</sup> Rule 1111(g), which would provide the Board authority to equitably re-allocate losses, costs and fees directly imposed as a result of a Partial Tear-Up among all non-defaulting Clearing Members through a special charge, would serve as a discretionary tool to redistribute the credit losses allocated through Partial Tear-Up.

<sup>57</sup> 17 CFR 240.17Ad–22(e)(v)(viii).

<sup>58</sup> 17 CFR 240.17Ad–22(e)(4)(ix).

<sup>59</sup> Under the existing approach, it is less certain from OCC’s standpoint regarding whether Clearing Members would reasonably be able to cap their liability to proportionate charges within five business days.



without further aggravating the extreme stresses facing market participants.

OCC recognizes that the proposed changes would limit the maximum amount of Clearing Fund resources that could be available to OCC in an extreme stress scenario, which introduces the possibility, however remote, that the proposed 200% cap ultimately could be reached. If during any cooling-off period the amount of aggregate proportionate charges against the Clearing Fund approaches the 200% cap, the amount remaining in the Clearing Fund may no longer be sufficient to comply with the applicable minimum regulatory financial resources requirements in the CCAs. In any such event, OCC's existing authority under Rule 603 would permit OCC to call on participants for additional initial margin, which could ensure that OCC's minimum financial resources remain in excess of applicable CCA requirements.<sup>60</sup> OCC recognizes that the imposition of increased margin requirements could have an immediate pro-cyclical impact on participants (and consequential impacts on the broader financial system) that is potentially greater than the impact of replenishing the Clearing Fund. These risks would be limited to a specific extreme stress event and could be mitigated by certain factors. First, OCC, in coordination with its regulators, would carefully evaluate any potential increase in the context of then-existing facts and circumstances. Second, during the cooling-off period, Clearing Members and their customers will have the opportunity to reduce or rebalance their respective portfolios in order to mitigate their exposures to stress losses and initial margin increases. Finally, since initial margin is not designed to be subject to mutualized loss, the risk of loss faced by Clearing Members for amounts posted as additional margin would be substantially less than for replenishments of the Clearing Fund.

Given the products cleared by OCC and the composition of its clearing membership, OCC has determined that a minimum 15-calendar day cooling-off period, rolling up to a maximum of 20 calendar days, is likely to be a sufficient amount of time for OCC to manage the ongoing default(s) and take necessary steps in furtherance of stabilizing the clearing system. Further, through conversations with Clearing Members, OCC believes that the proposed cooling-

off period is likely to be a sufficient amount for Clearing Members (and their customers) to orderly reduce or rebalance their positions, in an attempt to mitigate stress losses and exposure to potential initial margin increases as they navigate the stress event. Through conversations with Clearing Members, OCC also believes that the proposed cooling-off period is likely to be a sufficient amount for certain Clearing Members to orderly close-out their positions and transfer customer positions as they withdraw from clearing membership. OCC believes the proposed cooling-off period, coupled with the other proposed changes to OCC's assessment powers, is likely to provide Clearing Members with an adequate measure of stability and predictability as to the potential use of Clearing Fund resources, which OCC believes removes the existing incentive for Clearing Members to withdraw following a proportionate charge.<sup>61</sup>

In light of the foregoing, OCC believes that the proposed changes would enhance and strengthen its process to replenish the Clearing Fund following a default or other event in which use of the Clearing Fund is contemplated, in accordance with Rule 17Ad-22(e)(4)(ix).<sup>62</sup>

#### Replenishment of Liquid Resources

In relevant part, Rule 17Ad-22(e)(7)(ix) requires that each CCA "establish, implement, maintain and enforce written policies and procedures reasonably designed to . . . [d]escrib[e] the [CCA's] process to replenish any liquid resources that the clearing agency may employ during a stress event."<sup>63</sup> Since the use any part of the cash portion of OCC's Clearing Fund would constitute a depletion of one of OCC's liquid resources, OCC's assessment power, discussed above, is the primary means of replenishing the Clearing Fund cash that OCC used to address the stress event. For the same reasons stated above, OCC believes that the proposed changes enhance and strengthen its process to replenish the Clearing Fund, as necessary, following a default or other stress event in which the Clearing Fund is used, and therefore, OCC views

the proposed changes as consistent with Rule 17Ad-22(e)(7)(ix).<sup>64</sup>

#### Timely Action to Contain Losses

In relevant part, Rule 17Ad-22(e)(13) requires that each CCA "establish, implement, maintain and enforce written policies and procedures reasonably designed to . . . [e]nsure the [CCA] has the authority and operational capacity to take timely action to contain losses and liquidity demands and continue to meet its obligations . . . ." <sup>65</sup> The proposed changes would provide OCC with the authority to call for Voluntary Tear-Ups and OCC's Board with the discretion to impose Partial Tear-Ups, which would provide OCC with authority necessary to extinguish certain losses (and attendant liquidity demands) thereby potentially enabling OCC to continue to meet its remaining obligations to participants. As designed, Voluntary Tear-Ups and Partial Tear-Ups would be initiated on a date sufficiently in advance of the exhaustion of OCC's financial resources such that OCC is expected to have adequate resources remaining to cover the amount it must pay to extinguish the positions of Clearing Members and customers without haircutting gains. Accordingly, OCC believes that its authority and capacity to conduct a Partial Tear-Up should be timely, relative to the adequacy of OCC's remaining financial resources. Finally, OCC believes it has the operational and systems capacity sufficient to support the proposed changes, and OCC's policies and procedures will be updated accordingly to reflect the existence of these new tools. As a result, OCC believes that the proposed changes conform to the relevant requirements in Rule 17Ad-22(e)(13).<sup>66</sup>

#### Public Disclosure of Key Aspects of Default Rules

In relevant part, Rule 17Ad-22(e)(23)(i) requires that each CCA "establish, implement, maintain and enforce written policies and procedures reasonably designed to . . . [p]ublicly disclos[e] all relevant rules and material procedures, including key aspects of its default rules and procedures."<sup>67</sup> As stated above, each of the tools discussed herein are contemplated to be deployed by OCC if an extreme stress event has placed OCC into a recovery or orderly wind-down scenario, and therefore, the tools discussed herein constitute key aspects of OCC's default rules. By

<sup>60</sup> Rule 603 provides that "[t]he Risk Committee may, from time to time, increase the amount of margin which may be required in respect of a cleared contract, open short position or exercised contract if, in its discretion, it determines that such increase is advisable for the protection of [OCC], the Clearing Members or the general public."

<sup>61</sup> OCC initially considered a fixed 15-calendar day cooling-off period; however, OCC concluded that a fixed 15-calendar day cooling-off period may increase the risks of successive or cascading Clearing Member defaults and may perversely incentivize Clearing Members to seek to withdraw from clearing membership. Through conversations with Clearing Members, OCC believes that these potentially disruptive consequences are mitigated by the proposed rolling cooling-off period.

<sup>62</sup> 17 CFR 240.17Ad-22(e)(4)(ix).

<sup>63</sup> 17 CFR 240.17Ad-22(e)(7)(ix).

<sup>64</sup> 17 CFR 240.17Ad-22(e)(7)(ix).

<sup>65</sup> 17 CFR 240.17Ad-22(e)(13).

<sup>66</sup> 17 CFR 240.17Ad-22(e)(13).

<sup>67</sup> 17 CFR 240.17Ad-22(e)(23)(i).

incorporating the proposed changes into OCC's Rules and By-Laws, as further supplemented by the discussion in OCC's public rule filing, OCC believes that proposed changes would conform to the relevant requirements in Rule 17Ad-22(e)(23)(i).<sup>68</sup>

#### Sufficient Information Regarding the Risks, Fees and Costs of Clearing

In relevant part, Rule 17Ad-22(e)(23)(ii) requires that each CCA "establish, implement, maintain and enforce written policies and procedures reasonably designed to . . . [p]rovid[e] sufficient information to enable participants to identify and evaluate the risks, fees, and other material costs they incur by participating in the covered clearing agency."<sup>69</sup> The proposed changes would clearly explain to Clearing Members and market participants that an extreme stress scenario could result in the use—and theoretically the exhaustion—of OCC's financial resources, inclusive of OCC's proposed assessment powers. Proposed changes to Section 6, Article VIII of OCC's By-Laws would explain Clearing Members' replenishment obligation and liability for assessments. The proposed changes also would clearly explain, through proposed Rules 1011 and 1111, that as OCC nears the exhaustion of its assessment powers, Clearing Members may be asked for voluntary payments and, if necessary, Clearing Members and customers may be asked to participate in a Voluntary Tear-Up and/or subject to a Partial Tear-Up. Proposed Rules 1011(b) and 1111(a)(ii) also would make clear that Clearing Members that made voluntary payments and Clearing Members and customers whose tendered positions were extinguished in the Voluntary Tear-Up would be prioritized in the distribution of any recovery from the defaulted Clearing Member(s). Proposed changes to Article VIII would clarify that the Clearing Fund contributions remaining after OCC has conducted a Voluntary Tear-Up or Partial Tear-Up could be used to compensate the non-defaulting Clearing Members and non-defaulting customers for the losses, costs or fees imposed upon them as a result of such Voluntary Tear-Up or Partial Tear-Up. Proposed Rule 1111(g) would make clear that, following a Partial Tear-Up, OCC's Board may seek to equitably re-allocate losses, costs and fees directly imposed as a result of a Partial Tear-Up among all non-defaulting Clearing Members through a special charge. By incorporating the proposed changes into

OCC's Rules and By-Laws, as further supplemented by the discussion in OCC's public rule filing, OCC believes that it has provided sufficient information to enable participants to identify and evaluate the risks, fees, and other material costs they could incur by participating in OCC, consistent with the requirements in Rule 17Ad-22(e)(23)(ii).<sup>70</sup>

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

Section 17A(b)(3)(I) of the Act<sup>71</sup> requires that the rules of a clearing agency not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. OCC does not believe the proposed rule change would have any impact or impose any burden on competition. The primary purpose of the proposed changes is to make certain revisions to OCC's Rules and By-Laws that are designed to enhance OCC's existing tools to address the risks of liquidity shortfalls and credit losses and to establish tools by which OCC could re-establish a matched book following a default. As explained above, each of the tools proposed herein is contemplated to be deployed by OCC in an extreme stress event that has placed OCC into a recovery or orderly wind-down scenario. The proposed rule change is intended to provide Clearing Members, market participants and other stakeholders with greater certainty as to their liabilities and potential exposure to OCC in the event of an unprecedented loss scenario. OCC does not believe that the proposed changes would discriminatorily impact any Clearing Member's access to OCC's services or unnecessarily disadvantage or favor any particular user in relationship to another user. OCC recognizes that the nature of a Partial Tear-Up means that only particular Clearing Members and market participants holding certain positions may be impacted; however, the risk of Partial Tear-Ups is extremely remote, and even then, the proposed changes seek to provide means of equitably re-allocating the losses, costs and fees imposed by Voluntary Tear-Up or Partial Tear-Up. Therefore, OCC believes that the proposed changes would not have any impact or impose any burden on competition.

#### (C) Clearing Agency'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.

### 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 Commissions internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-OCC-2017-020 on the subject line.

#### Paper Comments

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

All submissions should refer to File Number SR-OCC-2017-020. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the

<sup>68</sup> 17 CFR 240.17Ad-22(e)(13).

<sup>69</sup> 17 CFR 240.17Ad-22(e)(23)(iii).

<sup>70</sup> 17 CFR 240.17Ad-22(e)(23)(ii).

<sup>71</sup> 15 U.S.C. 78q-1(b)(3)(I).

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 Section, 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 or identifying information from comment submissions. You should submit only information that you wish to make available publicly.

All submissions should refer to File Number SR–OCC–2017–020 and should be submitted on or before August 17, 2018.

For the Commission by the Division of Trading and Markets, pursuant to delegated authority.<sup>72</sup>

**Robert W. Errett,**  
Deputy Secretary.

[FR Doc. 2018–16535 Filed 8–1–18; 8:45 am]

BILLING CODE 8011–01–P

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–83726; File No. SR–MIAX–2018–16]

### Self-Regulatory Organizations; Miami International Securities Exchange LLC; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change To Amend Exchange Rule 518, Complex Orders

July 27, 2018.

Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”) <sup>1</sup> and Rule 19b–4 thereunder,<sup>2</sup> notice is hereby given that on July 16, 2018, Miami International Securities Exchange, LLC (“MIAX Options” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”) a proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

#### I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Exchange is filing a proposal to amend Exchange Rule 518, Complex Orders, to update its rule text regarding stock-option orders, in connection with the upcoming launch of such orders on the Exchange.

The text of the proposed rule change is available on the Exchange's website at <http://www.miaxoptions.com/rule-filings/> at MIAX Options' principal office, and at the Commission's Public Reference Room.

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

In its filing with the Commission, the Exchange 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. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

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

###### 1. Purpose

The Exchange proposes to amend Exchange Rule 518, Complex Orders, to update its rule text regarding stock-option orders, in connection with the upcoming launch of such orders on the Exchange. In particular, the Exchange is proposing to (i) adopt new rule text to introduce a new price protection feature for certain stock-option strategies, (ii) delete certain existing rule text to eliminate an unnecessary execution price restriction for the stock component of a stock-option strategy, and (iii) make certain minor clarifying edits to existing rule text.

Complex orders began trading on the Exchange on October 24, 2016.<sup>3</sup> In its rule filing to establish the trading of complex orders, the Exchange adopted rules for handling stock-option orders.<sup>4</sup> The Exchange also indicated that it would determine when stock-option orders would be made available for

trading in the System<sup>5</sup> and would communicate such determination to Members<sup>6</sup> via Regulatory Circular.<sup>7</sup> The Exchange is now proposing to make certain changes to its rule text, in connection with the upcoming launch of such orders on the Exchange, which is scheduled for the third quarter of 2018.

Currently, the Exchange provides price protection for certain complex option trading strategies such as Vertical Spreads<sup>8</sup> and Calendar Spreads<sup>9</sup> to prevent executions at potentially erroneous prices. Specifically, the Exchange provides a Vertical Spread Variance (“VSV”) price protection and a Calendar Spread Variance (“CSV”) price protection. The VSV establishes minimum and maximum trading price limits for Vertical Spreads.<sup>10</sup> The CSV establishes a minimum trading price limit for Calendar Spreads.<sup>11</sup> If the execution price of a complex order would be outside of the limits established for Vertical Spreads and Calendar Spreads, such complex order will be placed on the Strategy Book and will be managed to the appropriate trading price limit as described in Rule 518(c)(4), Managed Interest Process for Complex Orders. Orders to buy below the minimum trading price limit and orders to sell above the maximum trading price limit (in the case of Vertical Spreads) will be rejected by the System.<sup>12</sup>

The Exchange now proposes to adopt new subsection (g) in Rule 518, Interpretations and Policies .01, to provide a price protection feature for certain stock-option strategies that have a single option component tied to a stock component with a standard deliverable.<sup>13</sup> The proposed price protection feature, named “Parity Price Protection,” will provide price protection for strategies that consist of a

<sup>5</sup> The term “System” means the automated trading system used by the Exchange for the trading of securities. See Exchange Rule 100.

<sup>6</sup> The term “Member” means an individual or organization approved to exercise the trading rights associated with a Trading Permit. Members are deemed “members” under the Exchange Act. See Exchange Rule 100.

<sup>7</sup> See *supra* note 4.

<sup>8</sup> A “Vertical Spread” is a complex strategy consisting of the purchase of one call (put) option and the sale of another call (put) option overlying the same security that have the same expiration but different strike prices. See Exchange Rule 518.05(a).

<sup>9</sup> A “Calendar Spread” is a complex strategy consisting of the purchase of one call (put) option and the sale of another call (put) option overlying the same security that have different expirations but the same strike price. See Exchange Rule 518.05(b).

<sup>10</sup> See Exchange Rule 518.05(a).

<sup>11</sup> See Exchange Rule 518.05(b).

<sup>12</sup> See Exchange Rule 518.05(c).

<sup>13</sup> The standard stock deliverable is 100 shares.

<sup>72</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> See MIAX Regulatory Circular 2016–43, October 20, 2016.

<sup>4</sup> See Securities Exchange Act Release No. 79072 (October 7, 2016), 81 FR 71131 (October 14, 2016) (SR–MIAX–2016–26).