

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–89004; File No. SR–OCC–2020–802]

### Self-Regulatory Organizations; The Options Clearing Corporation; Notice of No Objection to Advance Notice Related to Proposed Changes to The Options Clearing Corporation's Framework for Liquidity Risk Management

June 4, 2020.

#### I. Introduction

On April 6, 2020, the Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission (“Commission”) advance notice SR–OCC–2020–802 (“Advance Notice”) pursuant to Section 806(e)(1) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, entitled Payment, Clearing and Settlement Supervision Act of 2010 (“Clearing Supervision Act”)<sup>1</sup> and Rule 19b–4(n)(1)(i)<sup>2</sup> under the Securities Exchange Act of 1934 (“Exchange Act”)<sup>3</sup> to adopt a written framework establishing OCC’s approach to managing liquidity risk.<sup>4</sup> The Advance Notice was published for public comment in the **Federal Register** on May 8, 2020,<sup>5</sup> and the Commission has received no comments regarding the changes proposed in the Advance Notice.<sup>6</sup> The Commission is hereby providing notice of no objection to the Advance Notice.

#### II. Background<sup>7</sup>

As noted above, OCC proposes to adopt a written framework establishing

OCC’s approach to managing liquidity risk. This written framework, the Liquidity Risk Management Framework (“LRMF”), sets forth a comprehensive overview of OCC’s liquidity risk management practices and governs OCC’s policies and procedures as they relate to liquidity risk management. In connection with implementing the proposed LRMF, OCC proposes to make revisions to its current rules regarding how OCC (1) maintains sufficient liquidity resources to meet its settlement obligations; (2) addresses foreseeable liquidity shortfalls not covered by OCC’s liquidity resources; (3) replenishes any of OCC’s resources employed during a stress event; (4) undertakes due diligence of OCC’s liquidity providers; and (5) requires each Clearing Member to have procedures to ensure operational capacity to meet its obligations arising from participation in OCC. OCC proposes to make conforming changes throughout its rules to effect the substance of the changes described below. Such changes would be made to OCC’s Clearing Fund and Stress Testing Methodology (“Methodology Description”), Risk Management Framework Policy, Clearing Fund Methodology Policy, Collateral Risk Management Policy, Counterparty Credit Risk Management Policy (“CCRM Policy”), and Default Management Policy.

The proposed LRMF describes the primary liquidity risks OCC faces when managing a Clearing Member default. To determine the amount of resources it needs, OCC assumes a two-day period of risk (*i.e.*, the period between a Clearing Member default and the settlement of the defaulted Clearing Member’s obligations). According to OCC, the potential liquidity obligations arising from a Clearing Member default may include mark-to-market obligations on futures and stock loan positions, trade premiums, cash-settled exercise and assignment (“E&A”) activity, auction payments, settlements resulting from the E&A of physically-settled options, and funding of OCC’s liquidation agents.<sup>8</sup> Such obligations would represent the specific liquidity risks that OCC would monitor, size, and manage as described in the LRMF. OCC would consider such potential obligations when determining its liquidity resources needs.

The proposed LRMF also describes factors that OCC would not consider when determining its liquidity

resources needs. Such factors include margin deficits and other payments associated with a liquidation (*e.g.*, brokerage, bank, and legal fees), which OCC states do not generally create immediate liquidity demands that could impede settlement. OCC also does not consider the costs it would directly bear to hedge open positions in its liquidity resource determinations because OCC’s primary goal is to liquidate positions prior to the need for hedging. Additionally, the proposed LRMF identifies liquidity risks that OCC would mitigate through tools other than the application of liquidity resources. Such risks include the operational failure or disruption of OCC’s liquidity providers, custodian, or settlement bank as well as potential concentration risks from key settlement banks and liquidity providers.

The proposed LRMF identifies and defines the four categories of liquidity resources that OCC would maintain: (1) “Base Liquidity Resources,” (2) “Available Liquidity Resources,” (3) “Required Liquidity Resources,” and (4) “Other Liquidity Resources.” The proposed LRMF defines Base Liquidity Resources as assets that are readily available and convertible into cash through prearranged funding arrangements<sup>9</sup> and required Clearing Fund cash on deposit.<sup>10</sup> The proposed LRMF defines Available Liquidity Resources as OCC’s Base Liquidity Resources plus Clearing Fund cash deposits in excess of the minimum required amount.<sup>11</sup> The proposed LRMF defines OCC’s Required Liquidity Resources, which are comprised of OCC’s Available Liquidity Resources plus any amount of cash margin deposits of a Clearing Member Group required under the Contingency Funding Plan (described below). Finally, the proposed LRMF describes OCC’s Other Liquidity Resources, which may or may not be available to OCC in a default situation (*e.g.*, non-cash margin deposits of the defaulting Clearing Member, including letters of credit, Government Securities, and Government Sponsored Entity securities

<sup>9</sup> OCC endeavors to maintain committed liquidity facilities with both bank and non-bank counterparties. OCC maintains a committed credit facility syndicated among various commercial banks. OCC also attempts to maintain committed repurchase agreements, which may be with either bank or non-bank counterparties.

<sup>10</sup> OCC’s rules require Clearing Members to collectively contribute \$3 billion in U.S. dollar cash to the Clearing Fund.

<sup>11</sup> OCC would only include excess cash deposits up to the amount the required Clearing Fund size exceeds the minimum Clearing Fund size as determined by OCC Rule 1001(b). Further, cash deposits in excess of a Clearing Member’s total Clearing Fund requirement would not be included.

<sup>1</sup> 12 U.S.C. 5465(e)(1).

<sup>2</sup> 17 CFR 240.19b–4(n)(1)(i).

<sup>3</sup> 15 U.S.C. 78a *et seq.*

<sup>4</sup> See Notice of Filing *infra* note 5, at 85 FR 27470.

<sup>5</sup> Securities Exchange Act Release No. 88792 (May 1, 2020), 85 FR 27470 (May 8, 2020) (File No. SR–OCC–2020–802) (“Notice of Filing”). On April 6, 2020, OCC also filed a related proposed rule change (File No. SR–OCC–2020–003) with the Commission pursuant to Section 19(b)(1) of the Exchange Act and Rule 19b–4 thereunder (“Proposed Rule Change”). 15 U.S.C. 78s(b)(1) and 17 CFR 240.19b–4, respectively. In the Proposed Rule Change, which was published in the **Federal Register** on April 24, 2020, OCC seeks approval of proposed changes to its rules necessary to implement the Advance Notice. Securities Exchange Act Release No. 88690 (Apr. 20, 2020), 85 FR 23095 (Apr. 24, 2020) (File No. SR–OCC–2020–003). The comment period for the related Proposed Rule Change filing closed on May 15, 2020.

<sup>6</sup> Since the proposal contained in the Advance Notice was also filed as a proposed rule change, all public comments received on the proposal are considered regardless of whether the comments are submitted on the Proposed Rule Change or the Advance Notice.

<sup>7</sup> Capitalized terms used but not defined herein have the meanings specified in OCC’s Rules and By-

Laws, available at <https://www.theocc.com/about/publications/bylaws.jsp>.

<sup>8</sup> See Notice of Filing, 85 FR at 27471.

that may be liquidated for same-day or next day settlement).

#### A. Sufficiency of Liquidity Resources

The proposed changes include rules designed to ensure the sufficiency of OCC's liquidity resources. Such rules address the maintenance of liquidity resources designed to address a variety of stress scenarios through the sizing of such resources and the management of certain Clearing Member cash collateral withdrawals. The proposal also describes OCC's approach to liquidity stress testing more generally, including OCC's internal reporting processes related to liquidity stress testing.

##### 1. Maintenance of Liquidity Resources

To ensure that OCC identifies the appropriate amount of liquidity resources it should maintain, OCC's proposed LRMF describes OCC's overall approach to liquidity stress testing and liquidity resource sizing. OCC's approach for liquidity stress testing would rely on the stressed scenarios and prices generated under OCC's current stress testing and Clearing Fund methodology.<sup>12</sup>

Under the proposal, OCC's Board of Directors ("Board") would, at least annually, determine the size of OCC's Base Liquidity Resources based on a recommendation from the Risk Committee of OCC's Board ("RC"). The RC's recommendation would be based on an internal analysis summarizing OCC's projected liquidity demands under a variety of stress scenarios, including the sufficiency of OCC's Base Liquidity Resources against extreme historical scenarios such as the 1987 market break and 2008 financial crisis, and certain scenarios used to size OCC's Clearing Fund.<sup>13</sup>

OCC proposes to revise how the Methodology Description describes key assumptions underlying OCC's calculation of its liquidity needs. Such assumptions include: (1) A two-day

liquidation horizon; (2) the default of a Clearing Member sometime between the collection of collateral on a given day and settlement of Clearing Member obligations to OCC on the following day (*i.e.*, the day of default, "D"); (3) the gross calculation of cash-settled option liquidity demands due on the morning of D; (4) the National Securities Clearing Corporation ("NSCC") normally guarantees the settlement of any E&A transactions; (5) the accounting of liquidity demands as required by relevant cross-margin agreements; (6) that auction bids for a defaulting Clearing Member's portfolio are represented by stressed prices at the contract level; (7) that credits that occur on the first day of a liquidation persist and are available to offset debits on subsequent days; (8) that auction proceeds settle on D+2; (9) liquidity demands associated with Specific Wrong Way Risk ("SWWR") positions are included in the appropriate calculations;<sup>14</sup> and (10) no early exercise of options occurs.<sup>15</sup>

Under the proposal, OCC would also make certain assumptions regarding the treatment of positions and cash flows based on timing. OCC would assume that positions with an expiration date of D+1 or greater will be liquidated via auction, and that option positions expiring on D-1 or D would be liquidated through normal OCC cash settlement processes or through physical settlement at NSCC. Under the proposed approach, cash inflows would be assumed to reduce outflows only for later dates.

To facilitate the maintenance of identified and collected liquidity resources, OCC proposes to require a two-day notice period for the substitution of non-cash collateral for cash in the Clearing Fund. Currently, a Clearing Member may execute a same-day substitution of Government Securities<sup>16</sup> for cash deposits in the Clearing Fund. Where substitution

would not cause a Clearing Member's settlement obligations to exceed the liquidity resources it has pledged to OCC, OCC would retain discretion to waive the proposed notice period. OCC stated that the proposed change is intended provide additional certainty around the level of liquidity resources available to OCC at any given time by fixing the amount of cash in the Clearing Fund, and thereby fixing the amount of OCC's Available Liquidity Resources, for any given two-day liquidation horizon.<sup>17</sup>

##### 2. Liquidity Stress Testing

As noted above, OCC's liquidity stress testing would be based on output of its current stress testing and Clearing Fund methodology. Daily, OCC performs stress tests designed to: (1) Determine whether OCC's collective financial resources are adequate to cover OCC's risk tolerance ("Adequacy Scenarios"); (2) establish the monthly size of the Clearing Fund based on the potential losses arising out of a 1-in-80 year hypothetical market event; (3) measure the exposure posed by individual Clearing Member Groups, and determine whether such exposure necessitates OCC calling for additional financial resources ("Sufficiency Scenarios"); and (4) monitor and assess the size of OCC's pre-funded financial resource against a wide range of stress scenarios that may include extreme but implausible and reverse stress testing scenarios ("Informational Scenarios").

OCC proposes to revise how the Methodology Description discusses OCC's stress testing and reporting processes to support the determination of its liquidity needs. OCC would change how it constructs portfolios for stress tests as well as how it aggregates stress test results consistent with the practices that OCC would follow in an actual liquidation of a defaulter's portfolio. Currently, OCC's processes focus on calculating the liquidating value of a portfolio. OCC proposes to revise its description of this process in its Methodology Description to highlight the importance of the timing of the cash flows during a liquidation because offsetting cash flows may occur on different days thus creating a liquidity demand during the process without a loss at the end of the process.<sup>18</sup>

<sup>12</sup> See Securities Exchange Act Release No. 83735 (Jul. 27, 2018), 83 FR 37855 (Aug. 2, 2018) (File No. SR-OCC-2018-008); Securities Exchange Act Release No. 83714 (Jul. 26, 2018), 83 FR 37570 (Aug. 1, 2018) (File No. SR-OCC-2018-803). OCC's current methodology considers a range of stress scenarios and possible price changes in liquidation periods, including but not limited to: (1) Relevant peak historic price volatilities; (2) shifts in other market factors including, as appropriate, price determinants and yield curves; (3) the default of one or multiple members; (4) forward-looking stress scenarios; and (5) reverse stress tests aimed at identifying extreme default scenarios and extreme market conditions for which the OCC's resources would be insufficient. See Notice of Filing, 85 FR at 27473.

<sup>13</sup> Such analysis would also consider the parameters and assumptions underlying OCC's stress testing system as well as the then current composition of OCC's liquidity resources.

<sup>14</sup> See Securities Exchange Act Release No. 87673 (Dec. 6, 2019), 84 FR 67981 (Dec. 12, 2019) (File No. SR-OCC-2019-807); Securities Exchange Act Release No. 87718 (Dec. 11, 2019), 84 FR 68992 (Dec. 17, 2019) (File No. SR-OCC-2019-010).

<sup>15</sup> OCC believes standard expiration is generally more meaningful than early exercise risk when calculating the liquidity risk associated with E&A activity. See Notice of Filing, 85 at 27476, n. 32. OCC provided data supporting this belief in a confidential Exhibit 3 to the Advance Notice.

<sup>16</sup> OCC defines "Government Securities" as securities issued or guaranteed by the United States or Canadian Government, or by any other foreign government acceptable to the Corporation, except Separate Trading of Registered Interest and Principal Securities issued on Treasury Inflation Protected Securities (commonly called TIP-STRIPS). OCC By-Laws, Article I, Section 1.G.(5), available at [https://www.theocc.com/components/docs/legal/rules\\_and\\_bylaws/occ\\_bylaws.pdf](https://www.theocc.com/components/docs/legal/rules_and_bylaws/occ_bylaws.pdf).

<sup>17</sup> See Notice of Filing, 85 FR at 27478.

<sup>18</sup> OCC also proposes changes to clarify the structure of Clearing Member accounts. For example, Clearing Members maintain separate accounts for separate business types or cross-margining arrangements. Further, positions and collateral credited to a particular type of Clearing Member account (*e.g.*, customer, firm or market-

OCC proposes to rely on the output from its Sufficiency Scenarios and Adequacy Scenarios to evaluate its liquidity resources. Under the proposed LRMF, OCC would assess its Base Liquidity Resources against its Adequacy Scenarios. OCC's proposed processes for increasing its Base Liquidity Resources as needed are described below. Similarly, OCC would evaluate the sufficiency of its Available Liquidity Resources based on the Sufficiency Scenarios.<sup>19</sup> OCC's proposed process for evaluating and supplementing its Available Liquidity Resources is also described below. OCC also proposes to make other conforming and organizational changes to the Methodology Description to reflect the implementation of the new liquidity stress testing approach and make other non-substantive clarifications to the document.<sup>20</sup>

The proposed LRMF also sets forth certain internal reporting processes related to OCC's liquidity stress testing. Daily, OCC staff would be required to review the output of OCC's liquidity stress tests, and such review could lead to a change in the size of OCC's Base Liquidity Resources. At least monthly, OCC staff would be required to develop and review reports detailing and analyzing OCC's daily stress tests.<sup>21</sup> OCC would use the analysis provided in such reports to review the parameters

maker) may be subject to a lien in favor of OCC, and such liens (or lack thereof depending on the account) would be contemplated in OCC's portfolio construction and aggregation processes.

<sup>19</sup> OCC also proposes to monitor and assess its liquidity resources under the Informational Scenarios. OCC would not be directly use the output of the Informational Scenarios to make decisions regarding the size of OCC's liquidity resources.

<sup>20</sup> For example, OCC would reorganize the document to relocate content specific to credit stress testing to sections of the document focused only on credit stress testing. OCC is also making clarifying and conforming changes to differentiate the usage of Adequacy, Sizing, Sufficiency, and Informational Scenarios for credit and liquidity purposes. Further, OCC proposes changes to more accurately describe the scope of volatility instruments cleared by OCC.

OCC proposes to clarify that in most SWWR stress test scenarios, SWWR Equity and ETN charges computed for margins are added to stress scenario profit and loss calculations in order to account for SWWR in the stress testing system. See Securities Exchange Act Release No. 87673 (Dec. 6, 2019), 84 FR 67981 (Dec. 12, 2019) (File No. SR-OCC-2019-807) and Securities Exchange Act Release No. 87718 (Dec. 11, 2019), 84 FR 68992 (Dec. 17, 2019) (File No. SR-OCC-2019-010). OCC also proposes removing duplicative language regarding Idiosyncratic Scenarios, Sizing Scenarios, and certain key assumptions from the executive summary of the Methodology Description because such information is covered in greater detail later in later sections of the document.

<sup>21</sup> Additionally, OCC staff would develop internal reports regarding the sufficiency of OCC's liquidity resources.

and assumptions underlying OCC's stress tests. OCC staff would conduct such analyses more frequently than monthly when products cleared or markets served display high volatility or become less liquid, or when the size or concentration of positions held by OCC's participants increases significantly. OCC staff would be required to provide a summary of the results from its at least monthly review to OCC's Management Committee and the RC. At least annually, OCC staff would be required to assess the adequacy of OCC's stress testing methodology, and provide such assessment to the RC. Also at least annually, OCC staff would be required to perform a review of risk methodologies and the usage of any models to inform the management of liquidity risk.

### *B. Foreseeable Shortfalls*

In determining the sufficiency of its liquidity resources as described above, OCC may identify a foreseeable liquidity shortfall. In such a situation, OCC's proposed changes provide OCC tools designed to address such foreseeable liquidity shortfalls not otherwise addressed by OCC's liquidity resources. The proposed LRMF contemplates mechanisms for increasing the size of OCC's Base Liquidity Resources. The proposed LRMF also describes OCC's plan for collecting additional resources when a Clearing Member Group's projected or actual liquidity risk exceeds certain thresholds ("Contingency Funding Plan").

#### **1. Increasing Base Liquidity Resources**

Under the proposed LRMF, OCC would maintain two tools by which it could increase its Base Liquidity Resources. As noted above, OCC maintains a committed credit facility with a syndicate of banks. The committed credit facility includes an uncommitted accordion feature,<sup>22</sup> which OCC will endeavor to include in future iterations of the facility.

OCC also requires Clearing Members to collectively contribute \$3 billion in cash to the Clearing Fund ("CF Cash Requirement"). OCC's current rules already authorize each of OCC's Executive Chairman, Chief Executive Officer, and Chief Operating Officer (collectively, the "OCEO") individually to increase the CF Cash Requirement on a temporary basis for the protection of OCC, Clearing Members or the general

public.<sup>23</sup> OCC requires that such temporary increases be reviewed by the RC. OCC proposes to expand its authority to set and to temporarily increase the CF Cash Requirement. OCC proposes to authorize its Board to adjust the CF Cash Requirement periodically except that the Board would not be permitted to set the CF Cash Requirement at an amount lower than \$3 billion. OCC also proposes that the OCEO may temporarily increase the CF Cash Requirement to respond to changing business or market conditions,<sup>24</sup> and to require that the RCs' review of such an increase must (i) be based upon then-existing facts and circumstances, (ii) be in furtherance of the integrity of OCC and the stability of the financial system, and (iii) take into consideration the legitimate interests of Clearing Members and market participants.<sup>25</sup> OCC also proposes to require that any increase in the CF Cash Requirement be satisfied no later than the second business day following notification unless the Clearing Member is notified by an officer of OCC an alternative time to satisfy such obligation.<sup>26</sup>

#### **2. Addressing Shortfalls in Available Liquidity Resources**

Currently, OCC forecasts daily settlement obligations 30 days prior to a given settlement under normal market conditions and compares such demands to its resources. Based on such analysis, OCC may require a Clearing Member to deposit intra-day margin in the form of cash so that OCC's liquid financial resources would be sufficient to cover the Clearing Member's obligations. OCC proposes to replace its current forecasting process with an analysis of OCC's resources measured against the output of its Sufficiency Scenarios. Under the proposed LRMF, OCC would

<sup>23</sup> OCC utilized this authority in December 2019 when it informed Clearing Members that OCC would exercise this authority on January 3, 2020 to increase the CF Cash Requirement temporarily from \$3 billion to \$3.5 billion during the monthly sizing of the Clearing Fund. See Securities Exchange Act Release No. 88120 (Feb. 5, 2020), 85 FR 7812, 7814 n. 20 (Feb. 11, 2020) (File No. SR-OCC-2020-801).

<sup>24</sup> OCC also proposes shifting the location of such authorization in its rules from Rule 1002 to the proposed LRMF.

<sup>25</sup> The criteria proposed for the RC's review are currently the criteria required for a member of the OCEO to authorize a temporary increase.

<sup>26</sup> OCC currently requires such temporary increases to be satisfied no later than one hour before the close of Fedwire on the business day following notification by OCC. OCC stated that the change is designed to provide more clarity and simplicity by more closely aligning the timeframes for meeting an increase in the CF Cash Requirement with the timing for satisfying Clearing Fund deficits in the monthly and intra-month sizing processes. See Notice of Filing, 85 FR at 27477-78.

<sup>22</sup> An accordion is an uncommitted expansion of a credit facility generally on the same terms as a credit facility.

take specific actions in the event that the output of its Sufficiency Scenarios for a given Clearing Member Group were to exceed one of two thresholds. Where OCC observes that the output of a Sufficiency Scenario is in excess of 80 percent of OCC's Available Liquidity Resources, OCC would initiate enhanced monitoring of the Clearing Member Group's liquidity demand.<sup>27</sup> Where OCC observes that the output of a Sufficiency Scenario is in excess of 90 percent of OCC's Available Liquidity Resources, OCC could require the Clearing Member Group to provide additional cash collateral ("Required Cash Deposits").<sup>28</sup> OCC proposes to amend its rules such that a Required Cash Deposit could be imposed either as part of OCC's normal daily margin process or as a special intra-day margin call.<sup>29</sup>

Similar to margin calls designed to ensure the sufficiency of OCC's financial resources, OCC proposes to establish two thresholds for monitoring the potential impact of a Required Cash Deposit on the relevant Clearing Member.<sup>30</sup> If the Required Cash Deposit for an individual Clearing Member were to exceed \$500 million or 75 percent of the Clearing Member's excess net capital, OCC staff would be required to notify OCC's OCEO. If the Required Cash Deposit for an individual Clearing Member were to exceed 100 percent of the Clearing Member's excess net capital, OCC staff would escalate the matter to the OCEO, any member of which would be authorized to approve such Required Cash Deposit. The thresholds described above would be subject to annual review and approval by the RC. Additionally, each member of the OCEO would be authorized to

approve temporary changes to the thresholds described above.<sup>31</sup>

Under the proposed LRMF, OCC would also have authority to impose Required Cash Deposits as a protective measure against a Clearing Member subject to enhanced monitoring and surveillance pursuant to OCC's watch level reporting process because OCC determines that the Clearing Member presents increased credit risk.<sup>32</sup> Specifically, OCC proposes to authorize such a requirement by adopting new Rule 604(g). Under the proposed rule, a Clearing Member may be required to satisfy such required cash deposits through its daily margin requirements under Rule 601 or through intra-day margin calls under Rule 609.

### C. Replenishment of Liquidity Resources

OCC's proposed changes include rules describing OCC's process for replenishing liquidity resources employed during a stress event. The proposal includes clarification of OCC's authority to borrow cash collateral from the Clearing Fund. The proposal also clarifies OCC's authority to reject substitutions that would affect non-cash Clearing Fund collateral that has been used to access OCC's liquidity facilities. Additionally, OCC proposes changes to its rules to allow for the more timely declaration and allocation of certain losses charged to the Clearing Fund.

The cash contributions to OCC's Clearing Fund serve as an important source of liquidity for OCC to manage potential liquidity risks associated with a Clearing Member default or the failure or operational disruption of a bank or securities or commodities clearing organization. Currently, OCC's rules permit OCC to use the Clearing Fund for borrowing or otherwise obtaining funds to be used for liquidity purposes. OCC has stated, however, that it would likely not use Clearing Fund cash as collateral for a loan from a third-party.<sup>33</sup> Rather, OCC would directly borrow Clearing Fund cash to manage the financial obligations of a defaulted Clearing Member. OCC proposes to amend its

rules to clarify its authority to borrow directly from the Clearing Fund.

The non-cash contributions to OCC's Clearing Fund provide a source of collateral necessary for OCC to access sources of liquidity such as OCC's liquidity facilities described above. Clearing Members may, from time to time, substitute new collateral for collateral already contributed to the Clearing Fund. OCC proposes to amend its rules to clarify its authority to reject substitutions that would affect collateral that OCC has already pledged as collateral to access its liquidity facilities.

Under OCC's rules, amounts obtained through borrowing from the Clearing Fund are not considered losses charged against the Clearing Fund for a period of 30 days. Any transaction collateralized by Clearing Fund contributions that is outstanding for more than 30 days is considered an actual loss that OCC would then allocate to its Clearing Members, who would then be required to replenish the Clearing Fund. OCC proposes to amend its rules to authorize OCC to determine that an outstanding transaction collateralized by Clearing Fund contributions is a loss to be allocated to Clearing Members, even if that transaction has been outstanding for less than 30 days, which in turn would allow OCC to allocate the loss and replenish the Clearing Fund in a timely manner.

### D. Due Diligence of Liquidity Providers

OCC's ability to manage its liquidity risk is dependent on a supporting institutions, such as settlement banks, custodian banks, central banks, and liquidity providers. The proposed LRMF describes OCC's overall framework for monitoring, managing, and limiting its risks and exposures to these supporting institutions.<sup>34</sup> This framework includes onboarding and monitoring processes, including: (1) Conducting due diligence to confirm each commercial institution meets OCC's financial and operational standards; (2) confirming each commercial institution's access to liquidity to meet its commitments to OCC; (3) monitoring and managing direct, affiliated, and concentrated exposures; and (4) conducting operational reviews of such institutions. The proposed LRMF also sets forth OCC's requirements for performing due diligence to confirm it has a reasonable

<sup>27</sup> OCC described the process comprising such enhanced monitoring in a confidential Exhibit 3G provided as part of the proposal.

<sup>28</sup> The amount of a Required Cash Deposit would be equal to 90 percent of OCC's Available Liquidity Resources less the relevant output of OCC's Sufficiency Scenario. Such a Required Cash Deposit could be provided as a substitute for non-cash collateral. OCC would generally require funding of Required Cash Deposits five business days before the date of the projected demand but may require funding up to 20 business days before the projected date as facts and circumstances may warrant.

<sup>29</sup> As proposed, OCC would generally require funding of Required Cash Deposits five business days before the date of the projected demand but could require funding up to 20 business days before the projected date.

<sup>30</sup> See Securities Exchange Act Release No. 83735 (Jul. 27, 2018), 83 FR 37855, 37858 (Aug. 2, 2018) (File No. SR-OCC-2018-008); Securities Exchange Act Release No. 83714 (Jul. 26, 2018), 83 FR 37570, 37572-73 (Aug. 1, 2018) (File No. SR-OCC-2018-803).

<sup>31</sup> The RC would be obligated to review any temporary change in thresholds within 20 days of the change to determine whether to make such change a permanent part of OCC's rules. The RC's determination must (i) be based upon then-existing facts and circumstances, (ii) be in furtherance of the integrity of OCC and the stability of the financial system, and (iii) take into consideration the legitimate interests of Clearing Members and market participants.

<sup>32</sup> OCC's watch level reporting process is outlined in its Counterparty Credit Risk Management Policy. See Securities Exchange Act Release No. 82312 (Dec. 13, 2017), 82 FR 60242 (Dec. 19, 2017) (File No. SR-OCC-2017-009).

<sup>33</sup> See Notice of Filing, 85 FR at 27480.

<sup>34</sup> OCC's framework for monitoring, managing, and limiting its risks and exposures to these supporting institutions is primarily governed by OCC's CCRM. See Securities Exchange Act Release No. 82312 (Dec. 13, 2017), 82 FR 60242 (Dec. 19, 2017) (File No. SR-OCC-2017-009).

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

#### *E. Participant Capacity*

Currently, OCC requires that each Clearing Member have access to sufficient financial resources to meet obligations arising from clearing membership in extreme but plausible market conditions. OCC's rules do not address circumstances in which a Clearing Member has sufficient resources to meet its obligations but is unable to meet settlement obligations due to a failure or operational issue at its primary settlement bank. OCC proposes to require that each Clearing Member maintain adequate procedures, including but not limited to contingency funding, to ensure that it is able to meet its liquidity obligations as OCC members.<sup>35</sup>

### **III. Commission Findings and Notice of No Objection**

Although the Clearing Supervision Act does not specify a standard of review for an advance notice, the stated purpose of the Clearing Supervision Act is instructive: To mitigate systemic risk in the financial system and promote financial stability by, among other things, promoting uniform risk management standards for SIFMUs and strengthening the liquidity of SIFMUs.<sup>36</sup>

Section 805(a)(2) of the Clearing Supervision Act authorizes the Commission to prescribe regulations containing risk management standards for the payment, clearing, and settlement activities of designated clearing entities engaged in designated activities for which the Commission is the supervisory agency.<sup>37</sup> Section 805(b) of the Clearing Supervision Act provides the following objectives and principles for the Commission's risk

management standards prescribed under Section 805(a):<sup>38</sup>

- To promote robust risk management;
- to promote safety and soundness;
- to reduce systemic risks; and
- to support the stability of the broader financial system.

Section 805(c) provides, in addition, that the Commission's risk management standards may address such areas as risk management and default policies and procedures, among other areas.<sup>39</sup>

The Commission has adopted risk management standards under Section 805(a)(2) of the Clearing Supervision Act and Section 17A of the Exchange Act (the "Clearing Agency Rules").<sup>40</sup> The Clearing Agency Rules require, among other things, each covered clearing agency to establish, implement, maintain, and enforce written policies and procedures that are reasonably designed to meet certain minimum requirements for its operations and risk management practices on an ongoing basis.<sup>41</sup> As such, it is appropriate for the Commission to review advance notices against the Clearing Agency Rules and the objectives and principles of these risk management standards as described in Section 805(b) of the Clearing Supervision Act. As discussed below, the Commission believes the changes proposed in the Advance Notice are consistent with the objectives and principles described in Section 805(b) of the Clearing Supervision Act,<sup>42</sup> and in the Clearing Agency Rules, in particular Rules 17Ad-22(e)(7) and (e)(18).<sup>43</sup>

#### *A. Consistency With Section 805(b) of the Clearing Supervision Act*

The Commission believes that the proposal contained in OCC's Advance Notice is consistent with the stated objectives and principles of Section 805(b) of the Clearing Supervision Act. Specifically, as discussed below, the Commission believes that the changes proposed in the Advance Notice are consistent with promoting robust risk management in the area of liquidity risk, promoting safety and soundness, reducing systemic risks, and supporting

the stability of the broader financial system.<sup>44</sup>

The Commission believes that the proposed changes are consistent with promoting robust risk management at OCC with a particular focus on the area of liquidity risk. OCC is a SIFMU,<sup>45</sup> and it is imperative that OCC have adequate resources to be able to satisfy its settlement obligations, including in the event of a Clearing Member default.<sup>46</sup> As described above, OCC proposes to adopt rules describing OCC's (i) primary liquidity risks, (ii) liquidity resources, (iii) requirements for liquidity provider due diligence, and (iv) requirements for procedures designed to ensure Clearing Member capacity to meet liquidity obligations arising out of participation in OCC. The Commission believes that having rules and policies that clearly determine and describe OCC's liquidity risks and resources would facilitate OCC's ability to size its liquidity resources commensurate with the risks it faces. OCC proposes to size and test the sufficiency of its liquidity resources based on its current credit stress tests, which include extreme historical scenarios such as the 1987 market break and 2008 financial crisis. Additionally, to support the application of OCC's current financial resource stress testing methodology to the management of liquidity risk, OCC proposes to revise its Methodology Description to describe the key assumptions underlying the calculation of OCC's liquidity needs. The Commission believes that measuring the sufficiency of OCC's resources based on extreme historical scenarios would support OCC's ability to manage such scenarios should they arise again. Further, the Commission believes that the incorporation of the key assumptions described above would strengthen OCC's understanding of its ability to meet its settlement obligations on time and in the required currency. Further, the proposal would require daily, monthly, and annual liquidity stress test-related reporting. The Commission believes that such reporting is necessary to provide risk management information to decision-makers within OCC because it would allow OCC to monitor its liquidity exposures under a variety of foreseeable stress scenarios, and to call for additional liquid resources in the form of cash deposits to ensure that OCC

<sup>38</sup> 12 U.S.C. 5464(b).

<sup>39</sup> 12 U.S.C. 5464(c).

<sup>40</sup> 17 CFR 240.17Ad-22. See Securities Exchange Act Release No. 68080 (Oct. 22, 2012), 77 FR 66220 (Nov. 2, 2012) (S7-08-11). See also Covered Clearing Agency Standards, 81 FR 70786. The Commission established an effective date of December 12, 2016 and a compliance date of April 11, 2017 for the Covered Clearing Agency Standards. OCC is a "covered clearing agency" as defined in Rule 17Ad-22(a)(5).

<sup>41</sup> 17 CFR 240.17Ad-22.

<sup>42</sup> 12 U.S.C. 5464(b).

<sup>43</sup> 17 CFR 240.17Ad-22(e)(7) and 17 CFR 240.17Ad-22(e)(18).

<sup>44</sup> 12 U.S.C. 5464(b).

<sup>45</sup> See Financial Stability Oversight Council ("FSOC") 2012 Annual Report, Appendix A, available at <https://www.treasury.gov/initiatives/fsoc/Documents/2012%20Annual%20Report.pdf>.

<sup>46</sup> See Securities Exchange Act Release No. 88317 (Mar. 4, 2020), 85 FR 13681, 13683 (Mar. 9, 2020) (File No. SR-OCC-2020-801) (citation omitted).

<sup>35</sup> OCC regularly examines its Clearing Members for adherence to similar obligations arising out of OCC's membership requirements in connection with its existing annual Clearing Member examination process.

<sup>36</sup> See 12 U.S.C. 5461(b).

<sup>37</sup> 12 U.S.C. 5464(a)(2).

continues to maintain sufficient liquid resources to meet its settlement obligations with a high degree of confidence. Finally, the proposal would require OCC to conduct due diligence of its liquidity providers and would require each Clearing Member to maintain policies and procedures to ensure its ability to meet its obligations arising out of participation in OCC. The Commission believes that such due diligence and membership requirements would allow OCC to more closely monitor the financial and operational capacity of its liquidity providers and Clearing Members. Such monitoring, in turn, would increase the likelihood that liquidity resources would be available to OCC when necessary. Taken together, the Commission believes that such proposed changes would promote robust risk management practices at OCC, consistent with Section 805(b) of the Clearing Supervision Act.<sup>47</sup>

The Commission also believes that the changes proposed in the Advance Notice are consistent with promoting safety and soundness. OCC proposes changes to facilitate increases in its Base Liquidity Resources, thereby allowing OCC to address settlement obligations that could exceed its Base Liquidity Resources, which could otherwise lead to liquidity shortfalls. OCC proposes to adopt practices for monitoring its Available Liquidity Resources against liquidity exposures projected under its Sufficiency Scenarios and to require Clearing Members to provide additional cash collateral in the form of margin deposits to address settlement obligations that could exceed OCC's Available Liquidity Resources, which would further help mitigate against liquidity shortfalls. Additionally, in particular, the Contingency Funding Plan would provide for enhanced monitoring of any Clearing Member Group whose projected liquidity exposures under OCC's Sufficiency Scenarios exceed 80 percent of OCC's Available Liquidity Resources. The proposal also would allow OCC to require Clearing Members subject to enhanced monitoring and surveillance under OCC's watch level reporting process to deposit additional cash margin as a protective measure. Finally, the proposed changes in the Advance Notice would impose a 2-day notice period for Clearing Fund cash collateral substitution requests, thereby providing at least two days of certainty regarding such resources, consistent with OCC's two-day liquidation horizon. The Commission believes that, taken together, these proposed changes would

promote safety and soundness at OCC by ensuring that OCC is able to obtain funds to address its liquidity exposure, including settlement obligations that could otherwise exceed its liquidity resources.

The Commission further believes that determining and obtaining sufficient funds to meet OCC's liquidity exposure, including settlement obligations, in turn, would enhance OCC's ability to manage systemic risk and to support the broader financial system by reducing the likelihood that OCC, in failing to address such exposures and obligations, would become a conduit for liquidity stresses into the broader financial system. Under the proposal, OCC would size its Base Liquidity Resources in a manner designed to consider extreme historical scenarios such as the 1987 market break and 2008 financial crisis, and would maintain such resources in anticipation of the occurrence of similarly severe market stresses. Sizing OCC's Base Liquidity Resources in this way would reduce the likelihood that OCC would be required to call for additional resources from, and thus impose potential liquidity pressure upon, Clearing Members and liquidity providers in times of potential market stress. Although OCC could impose Required Cash Deposits on Clearing Members in times of market stress, OCC's ability to manage the timing of this demand for liquidity up to 20 days in advance of the projected need would afford both OCC and its Clearing Members time to monitor and manage any potential stress such an action might cause. Further, as described above, in Section II.B.2. OCC proposes to establish thresholds for monitoring the potential effect of a Required Cash Deposit that could negatively impact a Clearing Member. Specifically, as noted above, OCC would consider a particular Clearing Member's ability to meet a Required Cash Deposit based on the absolute value of the Required Cash Deposit as well as how it relates to the affected Clearing Member's excess net capital. The Commission believes that prefunding Base Liquidity Resources, calling for Required Cash Deposits well in advance of a potential loss, and monitoring on an ex ante basis the potential impact on Clearing Members of Required Cash Deposits addresses both the need for OCC to manage its immediate liquidity needs and the need for OCC to identify and seek to manage any potential liquidity strains such actions may cause market participants. As such, the Commission believes that the Advance Notice is consistent with promoting safety and soundness,

reducing systemic risks, and promoting the stability of the broader financial system as contemplated in Section 805(b) of the Clearing Supervision Act.<sup>48</sup>

Accordingly, and for the reasons stated above, the Commission believes the changes proposed in the Advance Notice are consistent with Section 805(b) of the Clearing Supervision Act.<sup>49</sup>

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

Rule 17Ad-22(e)(7) under the Exchange Act requires that a covered clearing agency establish, implement, maintain, and enforce written policies and procedures reasonably designed to effectively measure, monitor, and manage the liquidity risk that arises in or is borne by the covered clearing agency, including measuring, monitoring, and managing its settlement and funding flows on an ongoing and timely basis, and its use of intraday liquidity.<sup>50</sup>

##### *1. Consistency With Sections (i), (vi), and (vii) of Rule 17Ad-22(e)(7)*

Rule 17Ad-22(e)(7)(i) under the Exchange Act requires that the covered clearing agency's policies and procedures be designed to require the maintenance of 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>51</sup>

As described above in section II.A.1., the Advance Notice includes OCC's method for sizing its liquidity resources. First, the proposed LRMF describes OCC's overall approach to liquidity stress testing and liquidity resource sizing by relying on the stressed scenarios and prices generated under OCC's current stress testing and Clearing Fund methodology, which the Commission has reviewed closely and believes would be consistent with identifying a wide range of foreseeable stress scenarios.<sup>52</sup> Specifically, the size

<sup>48</sup> 12 U.S.C. 5464(b).

<sup>49</sup> 12 U.S.C. 5464(b).

<sup>50</sup> 17 CFR 240.17Ad-22(e)(7).

<sup>51</sup> 17 CFR 240.17Ad-22(e)(7)(i).

<sup>52</sup> See Securities Exchange Act Release No. 83735 (Jul. 27, 2018), 83 FR 37855, 37862-63 (Aug. 2,

<sup>47</sup> 12 U.S.C. 5464(b).

of OCC's Base Liquidity Resources would be based upon an internal analysis summarizing OCC's liquidity demands under a variety of stress scenarios, including the sufficiency of OCC's Base Liquidity Resources against extreme historical scenarios such as the 1987 market break and 2008 financial crisis. Second, OCC proposes to describe key assumptions underlying the calculation of its liquidity needs—such as a two-day liquidation horizon—as well as the treatment of cash flows such that cash inflows would be assumed to reduce outflows only for later dates. Finally, OCC would impose a two-day notice requirement on substitutions of Clearing Fund collateral to ensure access to cash Clearing Fund contributions throughout the two-day liquidation period. Taken together, the Commission believes that these proposed changes are reasonably designed to ensure that OCC sizes and maintains its liquidity resources consistent with the requirements of Rule 17Ad-22(e)(7)(i) under the Exchange Act.<sup>53</sup>

Rule 17Ad-22(e)(7)(vi) under the Exchange Act requires that the covered clearing agency's policies and procedures be reasonably designed to determine the amount and regularly test the sufficiency of its liquid resources held for purposes of meeting the minimum liquid resource requirement under paragraph (e)(7)(i) of this section by, at a minimum: (A) Conducting stress testing of its liquidity resources at least once each day using standard and predetermined parameters and assumptions; (B) conducting a comprehensive analysis on at least a monthly basis of the existing stress testing scenarios, models, and underlying parameters and assumptions used in evaluating liquidity needs and resources, and considering modifications to ensure they are appropriate for determining the clearing agency's identified liquidity needs and resources in light of current and evolving market conditions; (C) conducting a comprehensive analysis of the scenarios, models, and underlying parameters and assumptions used in evaluating liquidity needs and resources more frequently than monthly when the products cleared or markets served display high volatility or become less liquid, when the size or concentration of positions held by the clearing agency's participants increases significantly, or

in other appropriate circumstances described in such policies and procedures; and (D) reporting the results of its analyses under Rules 17Ad-22(e)(7)(vi)(B) and (C) to appropriate decision makers at the covered clearing agency, including but not limited to, its risk management committee or board of directors, and using these results to evaluate the adequacy of and adjust its liquidity risk management methodology, model parameters, and any other relevant aspects of its liquidity risk management framework.<sup>54</sup> Rule 17Ad-22(e)(7)(vii) under the Exchange Act requires that the covered clearing agency's policies and procedures be reasonably designed to ensure the performance of model validation of its liquidity risk models not less than annually or more frequently as may be contemplated by the covered clearing agency's risk management framework.<sup>55</sup>

As described above in section II.A.2., OCC proposes to implement liquidity stress testing based on the output of its current stress testing and Clearing Fund methodology. After reviewing and assessing the proposal, including the methodology and results of OCC's proposed application of such output to its new liquidity stress testing approach, the Commission believes that the proposed changes described above are consistent with Rule 17Ad-22(e)(7)(vi) because OCC would assess its Base and Available Liquidity Resources against a set of stress scenarios, including extreme historical scenarios such as the 1987 market break and 2008 financial crisis. Further, the key assumptions described above in section II.A.1. would facilitate the application of OCC's current Clearing Fund stress testing outputs to the management of liquidity risk in a manner that would be consistent with OCC's management of credit risk. The Commission continues to believe that OCC's current stress testing methodology improved the testing of OCC's financial resources and increased the likelihood that OCC maintains sufficient resources at all times.<sup>56</sup> Similarly, the Commission believes that the application of such a methodology to liquidity risk management would improve the testing of OCC's liquidity resources and increase the likelihood that OCC maintains sufficient liquid resources at all times. Further, the Commission believes that applying a consistent risk management approach across OCC's

credit and liquidity risk exposures would support OCC's ability to maintain a more consistent, comprehensive view of its risk management processes more broadly.

Additionally, the Commission believes that the daily review of liquidity stress tests, which may lead to a change in OCC's Base Liquidity Resources would be consistent with the daily stress testing requirements of Rule 17Ad-22(e)(7)(vi)(A). Similarly, the Commission believes that the at least monthly analysis of daily stress tests for review of the parameters and assumptions underlying OCC stress tests with more frequent analysis as required would be consistent with the monthly comprehensive analysis requirements set forth in Rules 17Ad-22(e)(7)(vi)(B) and (C). Likewise, the Commission believes that providing a summary of such monthly reporting, as well as an annual assessment of the adequacy of OCC's liquidity resources based on such reporting, to OCC's Management Committee and the RC would be consistent with the reporting requirements of Rule 17Ad-22(e)(7)(vi)(D). Finally, the Commission believes that the review of risk methodologies and the usage of any models to inform the management of liquidity risk at least annually would be consistent with the model validation requirements set forth in Rule 17Ad-22(e)(7)(vii).

Taken together and for the reasons discussed above, the Commission believes that proposed approach to liquidity stress testing and reporting is consistent with the requirements of Rules 17Ad-22(e)(7)(vi) and (vii) under the Exchange Act.<sup>57</sup>

## 2. Consistency With Section (viii) of Rule 17Ad-22(e)(7)

Rule 17Ad-22(e)(7)(viii) under the Exchange Act requires that the covered clearing agency's policies and procedures be reasonably designed to address foreseeable liquidity shortfalls that would not be covered by the covered clearing agency's liquid resources and avoid unwinding, revoking, or delaying the same-day settlement of payment obligations.<sup>58</sup>

As described above in section II.B.1., OCC proposes to revise the available mechanisms for increasing its Base Liquidity Resources. The Commission believes such changes would be consistent with the requirements of Rule 17Ad-22(e)(7)(viii) because they would allow OCC to address settlement obligations that could exceed its Base

2018) (File No. SR-OCC-2018-008); Exchange Act Release No. 83714 (Jul. 26, 2018), 83 FR 37570, 37577-78 (Aug. 1, 2018) (File No. SR-OCC-2018-803).

<sup>53</sup> 17 CFR 240.17Ad-22(e)(7)(i).

<sup>54</sup> 17 CFR 240.17Ad-22(e)(7)(vi).

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

<sup>56</sup> See Securities Exchange Act Release No. 83714 (Jul. 26, 2018), 83 FR 37570, 37578 (Aug. 1, 2018) (File No. SR-OCC-2018-803).

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

<sup>58</sup> 17 CFR 240.17Ad-22(e)(7)(viii).



Liquidity Resources, which could otherwise lead to liquidity shortfalls. Specifically, by allowing OCC's Board to adjust the CF Cash Requirement, OCC would be able to adjust to increases in its liquidity needs by acquiring additional pre-funded liquidity resources. Similarly, the Commission believes that the proposed changes to the OCEO's authority to temporarily increase the CF Cash Requirement should allow OCC to quickly react to changes in both OCC's liquidity needs and liquidity resources while still preserving the required analysis and existing factors that OCC must consider under its current rules.

As described above in section II.B.2., OCC proposes a new Contingency Funding Plan, which would be described in OCC's rules. The Commission believes that OCC's proposed Contingency Funding Plan would be consistent with the requirements of Rule 17Ad-22(e)(7)(viii) because it would allow OCC to collect additional liquidity resources to address settlement obligations that could exceed OCC's Available Liquidity Resources, which could otherwise lead to liquidity shortfalls. In particular, the Contingency Funding Plan would provide for enhanced monitoring of any Clearing Member Group whose projected liquidity exposures under OCC's Sufficiency Scenarios exceed 80 percent of OCC's Available Liquidity Resources. Such monitoring should, in turn, facilitate OCC's ability to take further action as necessary, for example by temporarily increasing OCC's CF Cash Requirement. The Contingency Funding Plan would also provide OCC with additional liquidity resources in the form of cash margin deposits in the event that either (i) a Clearing Member Group's projected liquidity exposures under OCC's Sufficiency Scenarios exceed 90 percent of OCC's Available Liquidity Resources or (ii) it becomes necessary to impose protective measures on a Clearing Member on OCC's Watch List.<sup>59</sup>

Taken together and for the reasons discussed above, the Commission believes that proposed changes authorizing OCC to collect liquidity resources to address settlement obligations that could exceed its Base or Available Liquidity Resources are consistent with the requirements of Rule

17Ad-22(e)(7)(viii) under the Exchange Act.<sup>60</sup>

### 3. Consistency With Section (ix) of Rule 17Ad-22(e)(7)

Rule 17Ad-22(e)(7)(ix) under the Exchange Act requires, in part, that the covered clearing agency's policies and procedures be designed to effectively manage liquidity risk by, at a minimum, describing the covered clearing agency's process to replenish any liquid resources that the clearing agency may employ during a stress event.<sup>61</sup>

As described above in section II.C., OCC proposes to clarify and amend its rules related to borrowing Clearing Fund collateral. Specifically, OCC proposes to clarify its authority to borrow cash directly from the Clearing Fund and to reject substitution requests that would require the withdrawal of non-cash collateral that OCC has pledged to access a liquidity facility. The proposal would also authorize OCC to charge as a loss amounts obtained through borrowing against the Clearing Fund earlier than currently permitted under OCC's rules, thereby permitting OCC to require Clearing Members to provide collateral to replenish the Clearing Fund earlier than would otherwise be permitted under its existing rules. Taken together, the Commission believes that the proposed changes concerning OCC borrowing of Clearing Fund collateral and losses related to such borrowing are consistent with the requirements of Rule 17Ad-22(e)(7)(ix) under the Exchange Act.<sup>62</sup>

### 4. Consistency With Section (iv) of Rule 17Ad-22(e)(7)

Rule 17Ad-22(e)(7)(iv) under the Exchange Act requires that the covered clearing agency's policies and procedures be designed to require the undertaking of due diligence to confirm that it has a reasonable basis to believe each of its liquidity providers, whether or not such liquidity provider is a clearing member, has: (A) Sufficient information to understand and manage the liquidity provider's liquidity risks; and (B) the capacity to perform as required under its commitments to provide liquidity to the covered clearing agency.<sup>63</sup>

As described above in section II.D., the proposed LRMF explicitly contemplates OCC's due diligence for supporting institutions, including liquidity providers, to confirm OCC has a reasonable basis to believe each of its

liquidity providers has (1) sufficient information to understand and manage the potential liquidity demands of OCC and its associated liquidity risk and (2) the capacity to perform as required under its commitments. Such due diligence would include the execution of periodic tests at least once every 12 months to measure the performance and reliability of OCC's liquidity facilities. The Commission believes that proposed rules setting forth such due diligence requirements are consistent with the requirements of Rule 17Ad-22(e)(7)(iv) under the Exchange Act.<sup>64</sup>

Accordingly, the Commission believes that implementation of Advance Notice would be consistent with Rule 17Ad-22(e)(7) under the Exchange Act.<sup>65</sup>

### C. Consistency With Rule 17Ad-22(e)(18) Under the Exchange Act

Rule 17Ad-22(e)(18) under the Exchange Act requires, in part, that a covered clearing agency establish, implement, maintain, and enforce written policies and procedures reasonably designed to establish objective, risk-based, and publicly disclosed criteria for participation, which require participants to have sufficient financial resources and robust operational capacity to meet obligations arising from participation in the clearing agency.<sup>66</sup>

As described above in section II.E., OCC proposes to require that each Clearing Member maintain adequate procedures, including but not limited to contingency funding. More specifically, the proposed change would require Clearing Members to maintain procedures to address a failure or operational issue at a Clearing Member's settlement bank. Such a requirement would be in addition to the current requirement that Clearing Members have access to sufficient financial resources to meet obligations arising from clearing membership in extreme but plausible market conditions. The Commission believes that requiring Clearing Members to maintain such procedures would help to ensure that Clearing Members have the operational capacity to meet obligations arising from participation in OCC. The Commission believes, therefore, that the proposed change is consistent with the requirements of Rule 17Ad-22(e)(18) under the Exchange Act.<sup>67</sup>

<sup>59</sup> Such authority would be tempered by OCC's monitoring of the potential effect of calling for such resources based on the absolute value of the requirement as well as the size of the requirement relative to the affected Clearing Member's excess net capital.

<sup>60</sup> 17 CFR 240.17Ad-22(e)(7)(viii).

<sup>61</sup> 17 CFR 240.17Ad-22(e)(7)(ix).

<sup>62</sup> 17 CFR 240.17Ad-22(e)(7)(ix).

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

<sup>64</sup> *Id.*

<sup>65</sup> 17 CFR 240.17Ad-22(e)(7).

<sup>66</sup> 17 CFR 240.17Ad-22(e)(18).

<sup>67</sup> *Id.*



#### IV. Conclusion

It is therefore noticed, pursuant to Section 806(e)(1)(I) of the Clearing Supervision Act, that the Commission does not object to the Advance Notice (SR-OCC-2020-802) and that OCC is authorized to implement the proposed change as of the date of this notice or the date of an order by the Commission approving proposed rule change SR-OCC-2020-003 whichever is later.

By the Commission.

J. Matthew DeLesDernier,  
Assistant Secretary.

[FR Doc. 2020-12500 Filed 6-9-20; 8:45 am]

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#### SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-89020; File No. SR-CboeEDGX-2020-026]

#### Self-Regulatory Organizations; Cboe EDGX Exchange, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change To Adopt Rule 14.13 To Permit the Trading, Pursuant to Unlisted Trading Privileges, of Tracking Fund Shares

June 4, 2020.

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> notice is hereby given that on June 3, 2020, Cboe EDGX Exchange, Inc. (“Exchange” or “EDGX”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. The Exchange filed the proposal as a “non-controversial” proposed rule change pursuant to Section 19(b)(3)(A)(iii) of the Act<sup>3</sup> and Rule 19b-4(f)(6) thereunder.<sup>4</sup> 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 proposes a rule change to adopt Rule 14.13 to permit the trading, pursuant to unlisted trading privileges, of Tracking Fund Shares. Additionally, the Exchange proposes to make corresponding changes to Rule 14.1(a) to reference Tracking Fund Shares and proposed Rule 14.13, where

applicable. The text of the proposed rule change is provided in Exhibit 5.

The text of the proposed rule change is also available on the Exchange’s website ([http://markets.cboe.com/us/options/regulation/rule\\_filings/edgx/](http://markets.cboe.com/us/options/regulation/rule_filings/edgx/)), at the Exchange’s Office of the Secretary, 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 adopt Rule 14.13 to permit the trading, pursuant to unlisted trading privileges (“UTP”), of Tracking Fund Shares,<sup>5</sup> which substantially conforms to Cboe BZX Exchange, Inc. (“BZX”) Rule 14.11(m).<sup>6</sup>

<sup>5</sup> The term “Tracking Fund Share” means a security that: (i) Represents an interest in an investment company registered under the Investment Company Act of 1940 (“Investment Company”) organized as an open-end management investment company, that invests in a portfolio of securities selected by the Investment Company’s investment adviser consistent with the Investment Company’s investment objectives and policies; (ii) is issued in a specified aggregate minimum number in return for a deposit of a specified Tracking Basket and/or a cash amount with a value equal to the next determined net asset value; (iii) when aggregated in the same specified minimum number, may be redeemed at a holder’s request, which holder will be paid a specified Tracking Basket and/or a cash amount with a value equal to the next determined net asset value; and (iv) the portfolio holdings for which are disclosed within at least 60 days following the end of every fiscal quarter. See proposed Rule 14.13(c)(1).

<sup>6</sup> See Securities and Exchange Act Release No. 88887 (May 15, 2020) 85 FR 30990 (May 21, 2020) (SR-CboeBZX-2019-107) (the “BZX Approval Order”). The BZX proposal resulting in the BZX Approval Order involved several applications for exemptive relief that were filed with the Commission and for which public notice was issued on November 14, 2019 and a subsequent order granting certain exemptive relief to, among others, Fidelity Management & Research Company and FMR Co., Inc., Fidelity Beach Street Trust, and Fidelity Distributors Corporation (File No. 812-14364), issued on December 10, 2019 (the “Application,” “Notice,” and “Order,” respectively, and, collectively, the “Exemptive Order”). See

Additionally, the Exchange proposes to make corresponding changes to Rule 14.1(a) to reference Tracking Fund Shares and proposed Rule 14.13, where applicable.

The Exchange does not currently list any securities as a primary listing market.<sup>7</sup> Consistent with this fact, Exchange Rule 14.1(a) currently states that all securities traded on the Exchange are traded pursuant to UTP and that the Exchange will not list any securities before first filing and obtaining Commission approval of rules that incorporate qualitative listing criteria and comply with Rules 10A-3<sup>8</sup> (“Rule 10A-3”) and 10C-1<sup>9</sup> (“Rule 10C-1”) under the Act. Therefore, the provisions of existing Rules 14.2 through 14.9, 14.11 through 14.12, and proposed Rule 14.13 that permit the listing of certain Equity Securities<sup>10</sup>

Investment Company Act Release Nos. 33683 (November 14, 2019), 84 FR 64140 (November 20, 2019) (the Notice) and 33712 (the Order). The Order specifically notes that “granting the requested exemptions is appropriate in and consistent with the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act. It is further found that the terms of the proposed transactions, including the consideration to be paid or received, are reasonable and fair and do not involve overreaching on the part of any person concerned, and that the proposed transactions are consistent with the policy of each registered investment company concerned and with the general purposes of the Act.” The Exchange notes that it also referred to the application for exemptive relief orders (collectively, with the Application, the “Proxy Applications”) and notices thereof (collectively, with the Notice, the “Proxy Notices”) for T. Rowe Price Associates, Inc. and T. Rowe Price Equity Series, Inc. (File No. 812-14214 and Investment Company Act Release Nos. 33685 and 33713), Natixis ETF Trust II, et al. (File No. 812-14870 and Investment Company Act Release Nos. 33684 and 33711), Blue Tractor ETF Trust and Blue Tractor Group, LLC (File No. 812-14625 and Investment Company Act Release Nos. 33682 and 33710), and Gabelli ETFs Trust, et al. (File No. 812-15036 and Investment Company Act Release Nos. 33681 and 33708). While there are certain differences between the applications, the Exchange believes that each would qualify as Tracking Fund Shares under BZX Rule 14.11(m).

<sup>7</sup> The Exchange notes that it does not currently list any securities nor does it intend to list any securities in the foreseeable future and, accordingly, plans to submit in the near future a proposal to amend its applicable Rules set forth in Chapter XIV in order to reflect this fact.

<sup>8</sup> Rule 10A-3 obligates the Exchange to prohibit the initial or continued listing of any security of an issuer that is not in compliance with certain required standards. See 17 CFR 240.10A-3.

<sup>9</sup> Rule 10C-1 obligates the Exchange to establish listing standards that require each member of a listed issuer’s compensation committee to be a member of the issuer’s board and to be independent, as well as establish certain factors that an issuer must consider when evaluating the independence of a director. See 17 CFR 240.10C-1.

<sup>10</sup> As provided in Rule 14.1(a), the term “Equity Security” means, but is not limited to, common stock, secondary classes of common stock, preferred stock and similar issues, shares or certificates of

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

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

<sup>3</sup> 15 U.S.C. 78s(b)(3)(A)(iii).

<sup>4</sup> 17 CFR 240.19b-4(f)(6).