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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-88906; File No. SR-OCC-2020-803]

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of Advance Notice Concerning Changes to The Options Clearing Corporation's Non-Bank Liquidity Facility Program as Part of Its Overall Liquidity Plan

May 19, 2020.

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")¹ and Rule 19b-4(n)(1)(i)² under the Securities Exchange Act of 1934 ("Exchange Act"),³ notice is hereby given that on April 15, 2020, the Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("Commission") an advance notice 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 advance notice from interested persons.

I. Clearing Agency's Statement of the Terms of Substance of the Advance Notice

This advance notice is filed by The Options Clearing Corporation ("OCC") in connection with a proposed change to its operations to: (i) set the aggregate commitment amount that it may seek under its program for accessing additional committed sources of liquidity that do not increase the concentration of OCC's counterparty exposure ("Non-Bank Liquidity Facility") as part of OCC's overall liquidity plan¹ and (ii) allow more flexibility for OCC to negotiate the Non-Bank Liquidity Facility's commitment term. All

¹ 12 U.S.C. 5465(e)(1).

² 17 CFR 240.19b-4(n)(1)(i).

³ 15 U.S.C. 78a et seq.

terms with initial capitalization that are not otherwise defined herein have the same meaning as set forth in the OCC By-Laws and Rules.⁴

II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Advance Notice

In its filing with the Commission, OCC included statements concerning the purpose of and basis for the advance notice and discussed any comments it received on the advance notice. 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 and B below, of the most significant aspects of these statements.

(A) Clearing Agency's Statement on Comments on the Advance Notice Received from Members, Participants or Others

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

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

Description of Change

This advance notice concerns a change to OCC's operations to: (i) set the aggregate commitment amount that it may seek under the Non-Bank Liquidity Facility to up to \$1 billion as part of OCC's overall liquidity plan⁵ and (ii) allow more flexibility for OCC to negotiate the Non-Bank Liquidity Facility's commitment term.

Background

OCC's current liquidity plan provides it with access to a diverse set of funding

⁴ OCC's By-Laws and Rules can be found on OCC's public website: <http://optionsclearing.com/about/publications/bylaws.jsp>.

sources, including banks (i.e., OCC’s syndicated credit facility⁵ and a master repurchase agreement with a bank counterparty (“Repo Liquidity Facility”)⁶), the Non-Bank Liquidity Facility program,⁷ and Clearing Members’ Cash Clearing Fund Requirement.⁸ The Non-Bank Liquidity Facility program reduces the concentration of OCC’s counterparty exposure with respect to its overall liquidity plan by diversifying its lender base among banks and non-bank, non-Clearing Member institutional investors, such as pension funds or insurance companies.

The currently approved Non-Bank Liquidity Facility program is comprised of two parts: a Master Repurchase Agreement (“MRA”) and confirmations with one or more institutional investors, which contain certain individualized terms and conditions of transactions executed between OCC, the institutional investors and their agents. The MRA is structured like a typical repurchase arrangement in which the buyer (i.e., the institutional investor) would purchase from OCC, from time to time, United States government securities (“Eligible Securities”).⁹ OCC, as the seller, would transfer

⁵ See Exchange Act Release No. 85924 (May 23, 2019), 84 FR 25089 (May 30, 2019) (SR-OCC-2019-803).

⁶ See Exchange Act Release No. 88317 (March 4, 2020), 85 FR 13681 (March 9, 2020) (SR-OCC-2020-801).

⁷ See Exchange Act Release No. 73979 (Jan. 2, 2015), 80 FR 1062 (Jan. 8, 2015) (SR-OCC-2014-809) (“Notice of No Objection to 2014 Advance Notice”); Exchange Act Release No. 76821 (Jan. 4, 2016), 81 FR 3208 (Jan. 20, 2016) (SR-2015-805) (“Notice of No Objection to 2015 Advance Notice”).

⁸ See OCC Rule 1002.

⁹ OCC would use U.S. government securities that are included in Clearing Fund contributions by Clearing Members and margin deposits of any Clearing Member that has been suspended by OCC for the repurchase arrangements. OCC Rule 1006(f) and OCC Rule 1104(b) authorize OCC to obtain funds from third parties through securities repurchases using these sources. The officers who may exercise this authority include the Executive Chairman, Chief Executive Officer, and Chief Operating Officer.

Eligible Securities to the buyer in exchange for a payment by the buyer to OCC in immediately available funds (“Purchase Price”). The buyer would simultaneously agree to transfer the purchased securities back to OCC at a specified later date (“Repurchase Date”) or on OCC’s demand against the transfer of funds by OCC to the buyer in an amount equal to the outstanding Purchase Price plus the accrued and unpaid price differential (together, “Repurchase Price”), which is the interest component of the Repurchase Price.

The confirmations establish tailored provisions of repurchase transactions permitted under the Non-Bank Liquidity Facility that are designed to reduce concentration risk and to promote certainty of funding and operational effectiveness based on the specific needs of a party. For example, OCC would only enter into confirmations with an institutional investor that is not a Clearing Member or affiliated bank, such as pension funds or insurance companies, in order to allow OCC to access stable and reliable sources of funding without increasing the concentration of its exposure to counterparties that are affiliated banks, broker/dealers, or futures commission merchants. In addition, any such institutional investor is obligated to enter repurchase transactions even if OCC experiences a material adverse change,¹⁰ funds must be made available to OCC within 60 minutes of OCC’s delivering eligible securities, and the institutional investor is not permitted to rehypothecate purchased securities.¹¹

Additionally, the confirmations set forth the term and maximum dollar amounts of the

¹⁰ When included in a contract, a “material adverse change” is typically defined as a change that would have a materially adverse effect on the business or financial condition of a company.

¹¹ See Notice of No Objection to 2014 Advance Notice, 80 FR at 1064.

transaction permitted under the MRA.¹²

In 2019, the Non-Bank Liquidity Facility counterparty decided not to renew its commitments, and two confirmations totaling \$1 billion (“Prior Confirmations”) expired on January 2, 2020 and January 6, 2020. In anticipation of the expiration of the Prior Confirmations and to prevent a drop in OCC’s overall liquidity resources, OCC (i) exercised an accordion feature under its syndicated credit facility to increase the amount from \$2 billion to \$2.5 billion, and (ii) exercised authority under OCC Rule 1002 to temporarily increase the size of the Cash Clearing Fund Requirement from \$3 billion to \$3.5 billion.¹³ After obtaining regulatory approval, OCC also executed the Repo Liquidity Facility with a bank counterparty for \$500 million.¹⁴

Since learning that the Prior Commitments would not be renewed, OCC has also

¹² Because the arrangements between OCC and the individual buyers have not been fully negotiated, OCC has summarized the indicative terms in Exhibit 3a to File No. SR-OCC-2020-803. Exhibit 3a shows the terms indicated in prior advance notices, as modified by the proposed changes in this advance notice. The exhibit is a non-public document for which OCC has submitted a request for confidential treatment to the Commission.

¹³ After reviewing that temporary increase in accordance with Rule 1002, the Risk Committee determined to maintain the increase, which was already contemplated as part of a proposed rule change that OCC has since filed with the Commission. See File No. SR-OCC-2020-003. The proposed rule change would, among other things, modify Rule 1002 to allow OCC to periodically set the Clearing Fund Cash Requirement based on an analysis of OCC’s projected liquidity demands under a variety of stressed scenarios. Subject to regulatory approval of that filing, the Risk Committee would initially reset the Clearing Fund Cash Requirement to \$3.5 billion based on an analysis of stress test results demonstrating that this amount, in combination with OCC’s current and anticipated committed liquidity facilities—a \$2 billion syndicated credit facility and \$1 billion in other committed liquidity facilities (*i.e.*, the Repo Liquidity Facility and/or the Non-Bank Liquidity Facility)—would be sufficient to cover OCC’s liquidity risk tolerance of 1-in-50 year statistical market event at a 99.5% level over a two-year look back period.

¹⁴ After the Repo Liquidity Facility became effective, OCC terminated the \$500 million accordion on the syndicated credit facility.

been working with a lending agent to identify interested institutional investors to secure replacement Commitments for the \$1 billion in Prior Confirmations. The purpose of this filing is to modify certain aspects of the Non-Bank Liquidity Facility program to give OCC the flexibility to seek confirmations up to \$1 billion in the aggregate with such durations as approved by its Board of Directors (“Board”).

Aggregate Commitment Amount OCC May Seek Under the Confirmations

OCC is proposing to adjust the aggregate amount it can seek through the Non-Bank Liquidity Facility program to an amount up to \$1 billion, as opposed to no less than \$1 billion and no greater than \$1.5 billion—allowing OCC the ability to seek commitments even if the aggregate commitment level falls below \$1 billion. The Non-Bank Liquidity Facility program, as initially proposed, authorized commitments of \$1 billion in the aggregate.¹⁵ In 2015, OCC filed an advance notice to modify the Non-Bank Liquidity Facility program to allow OCC to seek aggregate commitments of no less than \$1 billion and no greater than \$1.5 billion (the “2015 Advance Notice”).¹⁶ The increase to the permissible range was made as part of OCC’s plan to transition from a single \$1 billion confirmation to two confirmations of \$500 million with staggered expiration dates.¹⁷ While the current Non-Bank Liquidity Facility program gives OCC discretion to seek aggregate commitments of no more than \$1.5 billion, OCC’s Board has consistently authorized OCC to seek commitments up to an aggregate amount of \$1 billion since 2016. OCC is proposing to modify the Non-Bank Liquidity Facility program to align the

¹⁵ Notice of No Objection to 2014 Advance Notice, 80 FR at 1064 & n.11.

¹⁶ Notice of No Objection to 2015 Advance Notice, 81 FR at 3208.

¹⁷ See id. at 3209 (discussing the extension of the existing confirmation and the execution of a second confirmation).

program's terms with the commitment level approved by the Board.

OCC's ability to secure or renew commitments under the Non-Bank Liquidity Facility is subject to market conditions, among other factors outside of OCC's control. As evidenced by the recent expiration of the Prior Confirmations, a counterparty's decision not to renew its commitment under the facility may cause the aggregate commitment amount to fall below \$1 billion. As part of OCC's overall liquidity plan, however, OCC maintains access to a diverse set of funding sources in addition to the Non-Bank Liquidity Facility. To address the expiration of a Non-Bank Liquidity Facility commitment, OCC would have several options, including (i) execution of one or more commitments under the Non-Bank Liquidity Facility up to the \$1 billion aggregate commitment amount proposed, (ii) exercising the accordion feature under the syndicated credit facility, (iii) exercising authority under OCC Rule 1002 to temporarily increase the Cash Clearing Fund Requirement, and (iv) filing an advance notice to execute a master repurchase agreement with other counterparties, similar to the Repo Liquidity Facility. Allowing OCC to seek one or more Non-Bank Liquidity Facility commitments that, in the aggregate, are less than \$1.0 billion would allow OCC the flexibility to adjust the mix of liquidity resources based on market conditions, availability and shifting liquidity needs. If OCC is unable to secure commitments to replace existing confirmations, OCC would reallocate shortfalls to other liquidity resources to prevent a drop in total liquidity resources.

Without this change, OCC arguably could not execute individual commitments that result in an aggregated commitment of less than \$1 billion at the time executed, making it difficult or impossible for OCC to negotiate individual commitments, each less than \$1 billion, with multiple counterparties that may be proceeding on different

timelines. In addition, allowing OCC to execute confirmations at different times would have the benefit of staggering expiration dates—to the extent such confirmations are for fixed terms—mitigating the risk that overlapping expirations may cause a drop in OCC’s overall liquidity resources.

Confirmation Term

OCC is also proposing to modify the confirmation term to allow more flexibility in negotiating terms with institutional investors. Confirmations under the current Non-Bank Liquidity Facility program are limited to a commitment term greater than or equal to 364-days. Based on ongoing negotiations with potential institutional investors, OCC believes there is interest for commitments that are shorter than one year.¹⁸ OCC is proposing to adjust the required terms and conditions as filed with the Commission in the 2015 Advance Notice filing to allow for a commitment term of less than 364 days, as negotiated by the parties and approved by OCC’s Board. The proposed modification to the program would allow for, among other things, a confirmation with a shorter commitment term as well as an open-ended term that allows for termination subject to a notice period. Providing flexibility in the commitment term may make the Non-Bank Liquidity Facility more commercially attractive to institutional investors who desire more flexibility in the confirmation term. Additionally, termination subject to notice would benefit OCC by ensuring that OCC will have a pre-set notice period to manage its liquidity resources to replace an expiring confirmation or adjust the levels of other liquidity resources.

¹⁸ OCC included information about the current status of negotiations with potential counterparties in Exhibit 3b to File No. SR-OCC-2020-803. The exhibit is a non-public document for which OCC has submitted a request for confidential treatment to the Commission.

The Board reviews proposed terms under the Non-Bank Liquidity Program and authorizes Management to enter into and renew transactions upon expiration. The length of term or notice period OCC would be willing to accept would be conditioned on factors including, but not limited to, the initial committed length of the term, market conditions and OCC's liquidity needs. For a confirmation without a defined commitment term, OCC would target to negotiate a six-month notice period. Based on the expiration of the Prior Confirmations, OCC believes that six-months' notice is sufficient time to allow OCC to reallocate liquidity resources to address a confirmation's termination. Because of the time and cost required to negotiate and close transactions, OCC believes it unlikely that it would pursue a commitment of less than three months.

Anticipated Effect On and Management of Risk

Completing timely settlement is a key aspect of OCC's role as a clearing agency performing central counterparty services. Modifying the Non-Bank Liquidity Facility program to provide OCC more flexibility in seeking confirmations would continue to promote the reduction of risks to OCC, its Clearing Members and the options market in general because it would allow OCC to continue to obtain short-term funds from the Non-Bank Liquidity Facility to address liquidity demands arising out of the default or suspension of a Clearing Member, in anticipation of a potential default or suspension of Clearing Members, the insolvency of a bank or another securities or commodities clearing organization, or the failure of a bank or another securities or commodities clearing organization to achieve daily settlement.

The Non-Bank Liquidity Facility helps OCC minimize losses in the event of a default, suspension, insolvency, or failure to achieve daily settlement, by allowing it to

obtain funds from sources not connected to OCC's Clearing Members on extremely short notice to ensure clearance and settlement of transactions in options and other contracts without interruption. OCC believes that the reduced settlement risk presented by OCC resulting from the proposed change would correspondingly reduce systemic risk and promote the safety and soundness of the clearing system. The ability to borrow funds from the Non-Bank Liquidity Facility would allow OCC to avoid liquidating margin or clearing fund assets in what would likely be volatile market conditions, which would preserve funds available to cover any losses resulting from the failure of a Clearing Member, bank or other clearing organization.

The proposed change to allow OCC to seek an aggregate commitment amount under the Non-Bank Liquidity Facility for up to the currently approved limit would help OCC ensure the continued availability of its liquidity resources by providing OCC with the flexibility to seek additional funding amounts at substantially the same terms, conditions, operations, and mechanics of the Prior Confirmations. Furthermore, allowing for OCC to negotiate a term less than 364-days would allow OCC more flexibility in negotiating confirmations with institutional investors, and would allow OCC the ability to negotiate terms that give OCC more time to respond to an institutional investor's decision not to renew a confirmation. Such flexibility would allow OCC to reallocate the amount of funding available under the confirmations at the time of a confirmation's renewal or termination and to manage liquidity needs and enhance its ability to ensure continual liquidity resources.

Because the proposed change preserves substantially the same terms and conditions as the MRA and the Prior Confirmation, OCC believes that the proposed

change would not otherwise affect or alter the management of risk at OCC.

Consistency with the Payment, Clearing and Settlement Supervision Act

The stated purpose of the Clearing Supervision Act is to mitigate systemic risk in the financial system and promote financial stability by, among other things, promoting uniform risk management standards for systemically important financial market utilities and strengthening the liquidity of systemically important financial market utilities.¹⁹

Section 805(a)(2) of the Clearing Supervision Act²⁰ also authorizes the Commission to prescribe risk management standards for the payment, clearing and settlement activities of designated clearing entities, like OCC, for which the Commission is the supervisory agency. Section 805(b) of the Clearing Supervision Act²¹ states that the objectives and principles for risk management standards prescribed under Section 805(a) shall be to:

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

The Commission has adopted risk management standards under Section 805(a)(2) of the Clearing Supervision Act and the Exchange Act in furtherance of these objectives and principles.²² Rule 17Ad-22 requires registered clearing agencies, like OCC, to establish, implement, maintain, and enforce written policies and procedures that are

¹⁹ 12 U.S.C. 5461(b).

²⁰ 12 U.S.C. 5464(a)(2).

²¹ 12 U.S.C. 5464(b).

²² 17 CFR 240.17Ad-22. See Exchange Act Release Nos. 68080 (October 22, 2012), 77 FR 66220 (November 2, 2012) (S7-08-11) (“Clearing Agency Standards”); 78961 (September 28, 2016), 81 FR 70786 (October 13, 2016) (S7-03-14) (“Standards for Covered Clearing Agencies”).

reasonably designed to meet certain minimum requirements for their operations and risk management practices on an ongoing basis.²³ Therefore, the Commission has stated²⁴ that it believes it is appropriate to review changes proposed in advance notices against Rule 17Ad-22 and the objectives and principles of these risk management standards as described in Section 805(b) of the Clearing Supervision Act.²⁵

OCC believes that the Non-Bank Liquidity Facility program, as modified, is consistent with Section 805(b)(1) of the Clearing Supervision Act²⁶ because the proposed confirmations would provide OCC with an additional source of committed liquidity to meet its settlement obligations while at the same time being structured to mitigate certain operational risks, as described above, that arise in connection with this committed liquidity source. In this way, the proposed changes are designed to promote robust risk management; promote safety and soundness; reduce systemic risks; and support the stability of the broader financial system.

OCC believes that the Non-Bank Liquidity Facility program, as modified, is also consistent with the requirements of Rule 17Ad-22(e)(7) under the Exchange Act.²⁷ Rule 17Ad-22(e)(7) requires OCC to establish, implement, maintain and enforce written policies and procedures reasonably designed to effectively measure, monitor, and manage liquidity risk that arises in or is borne by OCC, including measuring, monitoring, and managing its settlement and funding flows on an ongoing and timely basis, and its use of

²³ 17 CFR 240.17Ad-22.

²⁴ See, e.g., Exchange Act Release No. 86182 (June 24, 2019), 84 FR 31128, 31129 (June 28, 2019) (SR-OCC-2019-803).

²⁵ 12 U.S.C. 5464(b).

²⁶ 12 U.S.C. 5464(b)(1).

²⁷ 17 CFR 240.17Ad-22(e)(7).

intraday liquidity, as specified in the rule.²⁸ In particular, Rule 17Ad-22(e)(7)(i) under the Exchange Act²⁹ directs that OCC meet this obligation by, among other things, “[m]aintaining sufficient liquid resources at the minimum in all relevant currencies to effect same-day . . . settlement of payment obligations with a high degree of confidence under a wide range of foreseeable stress scenarios that includes, but is not limited to, the default of the participant family that would generate the largest aggregate payment obligation for [OCC] in extreme but plausible market conditions.”

As described above, the proposed change would allow OCC to seek a readily available liquidity resource that would enable it to, among other things, continue to meet its obligations in a timely fashion and as an alternative to selling Clearing Member collateral under what may be stressed and volatile market conditions. For these reasons, OCC believes that the proposal is consistent with Rule 17Ad-22(e)(7)(i).³⁰

Rule 17Ad-22(e)(7)(ii) under the Exchange Act requires OCC to establish, implement, maintain and enforce written policies and procedures reasonably designed to hold qualifying liquid resources sufficient to satisfy payment obligations owed to Clearing Members.³¹ Rule 17Ad-22(a)(14) of the Exchange Act defines “qualifying liquid resources” to include, among other things, lines of credit without material adverse change provisions, that are readily available and convertible into cash.³² The MRA under the Non-Bank Liquidity Facility would not be subject to any material adverse

²⁸ Id.

²⁹ 17 CFR 240.17Ad-22(e)(7)(i).

³⁰ Id.

³¹ 17 CFR 240.17Ad-22(e)(7)(ii).

³² 17 CFR 240.17Ad-22(a)(14).

change provision and would continue to be designed to permit OCC to, among other things, help ensure that OCC has sufficient, readily-available qualifying liquid resources to meet the cash settlement obligations of its largest Clearing Member Group. Therefore, OCC believes that the proposal is consistent with Rule 17Ad-22(e)(7)(ii).³³

For the foregoing reasons, OCC believes that the proposed changes are consistent with Section 805(b)(1) of the Clearing Supervision Act³⁴ and Rule 17Ad-22(e)(7)³⁵ under the Exchange Act.

III. Date of Effectiveness of the Advance Notice and Timing for Commission Action

The proposed change may be implemented if the Commission does not object to the proposed change within 60 days of the later of (i) the date the proposed change was filed with the Commission or (ii) the date any additional information requested by the Commission is received. OCC shall not implement the proposed change if the Commission has any objection to the proposed change.

The Commission may extend the period for review by an additional 60 days if the proposed change raises novel or complex issues, subject to the Commission providing the clearing agency with prompt written notice of the extension. A proposed change may be implemented in less than 60 days from the date the advance notice is filed, or the date further information requested by the Commission is received, if the Commission notifies the clearing agency in writing that it does not object to the proposed change and authorizes the clearing agency to implement the proposed change on an earlier date, subject to any conditions imposed by the Commission.

³³ 17 CFR 240.17Ad-22(e)(7)(ii).

³⁴ 12 U.S.C. 5464(b)(1).

³⁵ 17 CFR 240.17Ad-22(e)(7).

OCC shall post notice on its website of proposed changes that are implemented. The proposal shall not take effect until all regulatory actions required with respect to the proposal are completed.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the advance notice is consistent with the Clearing Supervision Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-OCC-2020-803 on the subject line.

Paper Comments:

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

All submissions should refer to File Number SR- OCC-2020-803. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the advance notice that are filed with the Commission, and all written communications relating to the advance notice 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 self-regulatory organization.

All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly.

All submissions should refer to File Number SR- OCC-2020-803 and should be submitted on or before [insert date 15 days from publication in the Federal Register].

By the Commission.

J. Matthew DeLesDernier,
Assistant Secretary.

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